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Office of Counsel
Advisory Opinion Unit

TSB-A-09(14)I
Income Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I070724B

Petitioner is a single-member limited liability company (SMLLC), treated as a disregarded entity for tax purposes. It asks whether the calculation of its Empire Zone (EZ) tax benefits will be affected if it elects under the federal treasury regulations to be taxed as a subchapter S corporation. The EZ tax credits in question are the wage tax credit (WTC), the EZ investment tax credit (EZ ITC) and EZ employment incentive credit (EZ EIC), the qualified empire zone enterprise (QEZE) real property tax credit (RPTC), and the QEZE tax reduction credit (TRC).

We conclude that the calculation of Petitioner's credits, in general, will not be affected.

Facts

Petitioner was certified under Article 18-B of the General Municipal Law prior to August 1, 2002 and has been claiming certain EZ tax credits. An entity like Petitioner that is not classified as a corporation under certain federal regulations[1] is "an eligible entity" and can elect its classification for federal tax purposes. An "eligible entity" with a single owner may be classified as either an association or a disregarded entity (DE).[2] If a business elects to be classified as an association, it will be treated for federal tax purposes as a corporation.[3] New York follows the election chosen by the taxpayer.

Petitioner has an EIN separate and apart from the social security number of its single member. A SMLLC will be treated as a DE unless it makes an election to change its classification[4] under Treasury Regulation 301.7701-3(c). Petitioner, at the time this petition was submitted, had made no such election. Thus, Petitioner reports its income or loss on federal Schedule C, which is included in the individual tax return of its single member, who files under Article 22 of the Tax Law. The credits it claims are calculated on Forms IT-601, IT-603, IT-604, and IT-606, and claimed on Form IT-201-ATT submitted by its single member.

In the proposed transaction, Petitioner would file an S corporation election under Internal Revenue Code (IRC) §1362 and New York Tax Law §660. For federal purposes, when Petitioner makes an S corporation election under the IRC, no actual election under Treasury Regulation 301.7701-3(c)(1) would be required for Petitioner to be classified as a corporation. Under Treasury Regulation 301.7701-3(c)(1)(v)(C), Petitioner will be deemed to have made the election to become a corporation, as opposed to a DE, effective when the S corporation election is made. After the change in tax classification, Petitioner will continue to be owned by the same individual and the EIN of the business will remain the same. As a New York S corporation, Petitioner will calculate the EZ tax benefits on CT-601, CT-603, CT-604, and

[1] Treasury Regulation 301.7701-2(b))(1), (3), (4), (5), (6), (7), or (8).
[2] Treasury Regulation 301.7701-3(a).
[3] Treasury Regulation 301.7701-2(b)(2).
[4] Treasury Regulation 301.7701-3(b).

CT-606, and report them to the shareholder on New York Schedule K-1. The shareholder will claim the tax benefits on IT-201-ATT to reduce the tax under Article 22.

Analysis

To claim any of the credits above, an entity must be certified under Article 18-B of the General Municipal Law (GML) and meet the other statutory requirements for the credits. Issues related to certification of an entity are not within our purview. For purposes of this opinion, we will assume that Petitioner is and remains certified. We caution, however, that although an SMLLC/DE and its single member are generally treated as one taxpayer, and either of them may be certified in order for the single member to claim the EZ tax credits, this is not the case when the SMLLC is classified as an S corporation. For purposes of New York Tax Law, an S corporation is regarded as a separate taxpayer from its single shareholder and must be separately certified.[5]

Federal regulations permit certain business entities, such SMLLCs, to elect to be classified for tax purposes as either a DE or an association (and thus, a corporation), and periodically to change the elected tax classification of the entity.[6] While Petitioner does not plan to convert to an S corporation by means of incorporation, the tax attributes are the same under federal tax law as if a legal change in the entity had occurred. Under federal regulations, a change in tax classification from a DE to an association is accorded tax attributes consistent with the provisions for non-recognition of gain and losses under the provisions of the IRC.[7] IRC §351 provides that no gain or loss is recognized, if property is transferred to a corporation by one or more persons solely in exchange for stock in the corporation, and immediately after the exchange, such person or persons are in control of the corporation.

New York follows federal law in treating an SMLLC as either a DE or an association (i.e., as a corporation for tax purposes). If an SMLLC elects to be treated as an association for federal purposes, it will be taxed under Article 9-A of the Tax Law. "The term 'corporation' includes (a) an association within the meaning of paragraph three of subsection (a) of section seventy-seven hundred one of the internal revenue code (including a limited liability company)…."[8] New York, however, does not automatically follow the federal S corporation election. The members of the entity must affirmatively elect under §660 of the Tax Law to be treated as a New York S corporation, in order for the entity to pass through items of income, loss, deduction, and reductions for taxes, which are taken into account for federal income tax purposes for the taxable year.[9] If the election under §660 is made, the New York S corporation itself is subject to the fixed dollar minimum tax under Article 9-A.[10] Aside from that tax, the tax liability for income or loss of Petitioner would be passed through to the same Article 22 taxpayer, regardless of Petitioner's tax classification.

For purposes of the EZ WTC, Petitioner will calculate the credit at the S corporation level and pass the credit through to its member. The change in the tax classification from a DE to an S corporation does not change the legal make-up of the entity; the member of the SMLLC remains the same. Therefore, the change in the classification of a DE to an S corporation should not extend the 5-year benefit period for

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[5] NYT-G-07(5)(C),(1)I.
[6] 26 C.F.R. §301.7701-3(a).
[7] 26 C.F.R. §301.7701-3(g)(4).
[8] § 208.1 of the Tax Law.
[9] § 660(a) of the Tax Law. Note that under certain circumstances, an S election will be deemed for New York tax purposes. See §660(i).
[10] §210.1(g).

the WTC. The EZ WTC will be available to Petitioner treated as a New York S corporation for the remaining years in which Petitioner treated as a DE could have claimed the credit. The base years, test year, and employment number for those years are the same for the period that Petitioner was treated as an S corporation and the period when Petitioner was treated as a DE. The credit, once calculated, will then be passed through to the same individual taxpayer, that is, the shareholder of the S corporation, and reported under Article 22.

For purposes of the EZ ITC, changing the tax classification of Petitioner from a DE to a New York S corporation will not be viewed as a disposition of the property. The EZ ITC provides, in general, that a disposition of qualified property includes a contribution of property to a partnership or corporation, unless a substantial interest in the ownership of the trade or business is retained by the transferor. [11] In this case, Petitioner's single member, whether Petitioner is classified as a DE or subsequently as an S corporation, would remain the same and continue to claim the credit against the Article 22 taxes; the title to the property would be held by the same legal entity, the SMLLC; and the property would continue in the qualified use. Such qualities are inconsistent with the principles in the definition of a disposition, outlined in the regulations governing the EZ ITC.[12] Thus, if Petitioner's tax classification is changed from a DE to a New York S corporation, no disposition will be deemed to have occurred, the basis of the property will remain the same as when Petitioner was treated as a DE, and the required period of qualified use will be calculated by aggregating the years of use by the SMLLC when classified as a DE and when classified as a New York S corporation. Because Petitioner treated as an S corporation will take over the property at the basis established when Petitioner was treated as a DE, the change does not qualify as a "purchase," and Petitioner may not claim the EZ ITC after the change in classification unless new funds that qualify for the EZ ITC are expended. Any carryover credit not used prior to the change in classification may be carried over by the single member and subtracted from the single member's income tax.

A shareholder of a New York subchapter S corporation eligible to claim the EZ ITC[13] will be treated as the taxpayer with respect to the corresponding credit base of such corporation.[14] The EZ EIC is available when a taxpayer is allowed the EZ ITC and an employment test is met.[15] Because both the EZ ITC and the EZ EIC are allowed to a shareholder of an S corporation under §606(i) of the Tax Law, Petitioner's single member will be able to claim both credits.

For purposes of the QEZE RPTC and QEZE TRC, a business enterprise must be certified under Article 18-B of the General Municipal Law and pass the employment test in §14(b) of the Tax Law. This QEZE statute, unlike other statutes for EZ tax benefits, requires the "business enterprise" to be certified, as opposed to "the taxpayer." Although "business enterprise" is not defined in the Tax Law, it can be said that the "business entity" is Petitioner, the SMLLC. Thus, when Petitioner elects to be treated as an S corporation, it may claim the credits for the benefit period remaining to Petitioner when it was treated as a DE. The base years, test year, and employment number for those years are the same for the period that Petitioner was treated as an S corporation and the period when Petitioner was treated as a DE. For a corporation first certified before August 1, 2002, the new business test is not applicable, if the business enterprise has a base period greater than zero and an employee in the base period.[16] Your letter states that

[11] 20 NYCRR §106.1(i)(1)(v)(f).
[12] 20 NYCRR §106.7 and §5-10.8(g).
[13] §606(j) of the Tax Law.
[14] § 606(i) of the Tax Law.
[15] § 606(j-1) of the Tax Law.
[16] §14(j)(4)(B) of the Tax Law.

Petitioner has been claiming EZ tax benefits. Thus, it appears that the new business test is inapplicable. If the other requirements of the statutes are met, Petitioner will be eligible to earn the QEZE RPTC and the QEZE TRC for the balance of the benefit period, which began in the year when Petitioner was first certified. The base period of Petitioner, test year, test date, and calculations of the employment test and employment number will include the period of time when the SMLLC is classified as a DE and when it is classified as an S corporation.

DATED: November 4, 2009

/S/
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