

New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-11(1)I
Income Tax
February 11, 2011

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. 1101101A

Petitioners [REDACTED] and (collectively, "Petitioners") ask whether an increase to Petitioners' basis in S corporation stock should be allowed for New York State tax purposes subsequent to certain state and federal income tax modifications related to the corporation's conversions from a C corporation to an S corporation.

We conclude that there is no statutory authority to increase the shareholders' bases in their S corporation stock for New York tax purposes.

Facts

Petitioners are shareholders in a New York subchapter S corporation which recently converted from a subchapter C corporation. Pursuant to section 1374 of the Internal Revenue Code, a built-in gains tax was imposed upon the S corporation's net recognized built-in gain subsequent to the conversion from a subchapter C corporation. Under section 1366(f)(2) of the Internal Revenue Code, the amount of the corporate tax paid was treated as a loss sustained by the S corporation during the taxable year, and as a deduction in the same amount on the Petitioners' individual federal income tax returns. That amount was then added back in to Petitioners' respective federal adjusted gross incomes for New York State tax purposes pursuant to Section 612(b)(18) of the Tax Law. This addition has caused an increase in each of the Petitioners' New York tax liabilities and they are, therefore, requesting an increase in their respective stock bases to the extent of the amount of such addition.

Analysis

Section 1374 of the Internal Revenue Code ("IRC") imposes a corporate-level tax on an S corporation's net recognized built-in gain during the recognition period in the case of a C corporation's conversion to S corporation status (IRC §1374(a)) or an S corporation's acquisition of assets in a transaction in which the S corporation's basis in the acquired assets is determined by reference to the basis of such assets in the hands of a C corporation (IRC §1374(d)(8)). Recognized built-in gain includes any gain recognized on the disposition of an asset during the recognition period, except to the extent the S corporation establishes that it did not hold the asset on the conversion date or §1374(d)(8) transaction date, or that the gain recognized was greater than the excess of the asset's fair market value over its adjusted basis on the date (IRC §1374(d)(3)). Section 1374(d)(3) applies to any gain recognized during the recognition period in a transaction treated as a sale or exchange for Federal income tax purposes (Treas. Reg. §1.1374-4(a)).

The Petitioners are shareholders in a subchapter S corporation which was assessed the built-in gains tax pursuant to its conversion from a subchapter C corporation. Subsequent to this assessment, the amount of the corporate gains tax paid was treated as a loss sustained by the S corporation during the taxable year, and as a deduction in the same amount on the Petitioners' respective individual federal income tax returns pursuant to §1366(f)(2) of the Internal Revenue Code. That proposed audit adjustment

is to add that amount back to Petitioners' federal adjusted gross income for New York State tax purposes pursuant to §612(b)(18) of the Tax Law.

New York Tax Law does permit certain modifications of adjusted gross income attributable to federal basis changes. *See, e.g.*, Tax Law §612(n) (federal adjusted gross income modifications for gain or loss upon disposition of stock); §612(r) (federal adjusted gross income modifications for certain related members expense add backs); §612(s) (federal adjusted gross income modifications in a New York S termination year). However, there are no corresponding Tax Law provisions allowing Petitioners to increase their respective bases due to the section 612(b)(18) add back. Nor are there any provisions to decrease Petitioners' respective gain, or increase their respective loss, upon disposition of the S corporation stock as a result of the add back of section 612(b)(18). In the absence of such statutory authority, Petitioners cannot increase their respective bases for New York purposes beyond their federal adjusted basis.

DATED: February 11, 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.