New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-87 (5) I
Income Tax
October 20, 1987

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I870714A

On July 14, 1987, a Petition for Advisory Opinion was received from Beverly A. Grillo, 187 Shirley Avenue, Buffalo, New York 14215.

The issue raised is whether an "S Corporation" may qualify as a "new business" for purposes of subsections (o), (p) and (q) of section 612 of the Tax Law.

Petitioner has realized long-term capital gains from the sale of capital assets and intends to reinvest the proceeds in a "new business" in New York State. The business will be conducted in the form of an S Corporation .

Section 660 of the Tax Law provides that if a corporation which is an S corporation for federal income tax purposes is subject to tax under Article 9-A of the Tax Law, the shareholders may, by fulfilling certain requirements, elect to treat the corporation as an S corporation for state tax purposes.

Section 209(8) of Article 9-A of the Tax Law provides that "[a] taxpayer which is an S corporation for federal income tax purposes shall not be subject to the tax under this article for any taxable year for which an election is in effect pursuant to subsection (a) of section six hundred sixty of this chapter."

The Tax Law provides two personal income tax incentives designed to encourage investment in new businesses in New York State. These are: (1) full or partial exclusion from taxable income for capital gains realized upon the sale of a "new business investment" (Tax Law § 612(o)); and (2) deferral of capital gain realized on the sale of a capital asset for the period that the proceeds are reinvested in a "New York new business" (Tax Law § 612(p)).

However, to qualify as a new business for purposes of section 612(o), a corporation or partnership must meet the requirements specified in section 612(o)(1)(B). Pursuant to section 612(o)(1)(B), a corporation or partnership must, among other requirements: (1) adopt a plan on or after July 1, 1981 and before January 1, 1988 to conduct a new business and issue new business investments; (2) be subject to taxation (whether or not any amount is owing) under Article 9-A of the Tax Law or under certain other sections or articles of the Tax Law at the date of adoption of such plan; (3) have the first taxable period for which the new business becomes subject to tax on or after July 1, 1981 and before January 1, 1988, such first taxable period to include the date of adoption of such plan; and (4) if not so subject to taxation at such date of adoption, the new business must be subject to taxation under such sections or articles for the first time within one year from the date of adoption of such plan.

Accordingly, for purposes of qualifying as a new business for purposes of section 612(o), a corporation cannot be an S corporation at the date of adoption of its new business plan because an S corporation is not subject to tax under Article 9-A of the Tax Law at the date of adoption of the new business plan as required by the statute. However, section 612(o) contains no prohibition against election of S corporation status at a date subsequent to the date of adoption of the new business plan.

Subsection 612(p) of the Tax Law provides a new business investment deferral for taxable years beginning before January 1, 1988.

Definitions governing the new business investment deferral differ from those pertaining to the exclusion for new business investment gains. To qualify for the new business investment deferral, a new business is a business enterprise that meets all of the following requirements as set forth in § 612(p) of the Tax Law:

1. The business has been a taxpayer under Article 22 for no more than three taxable years, including short taxable years, and

2. Over fifty percent of the number of shares of stock that entitle holders to vote for the election of directors or trustees is not owned, directly or indirectly, by a taxpayer subject to taxes under § 184, 185 or 186 of Article 9 of Chapter 60 of the Tax Law, or under Article 9-A, 32 or 33 of the same chapter, and

3. The business is not substantially similar in operation or ownership, directly or indirectly, to a business entity taxable, or previously taxable, under the above named corporation taxes, or would have been taxable under the unincorporated business tax, or the income (or losses) of which is (or was) includable under article twenty-two whereby the intent and purpose of this subsection would be evaded, and

4. The business locates and employs at least ninety percent of its assets in the state, and

5. The business employs principally in New York State eighty percent of its employees, with the exclusion of general executive officers and partners, and

6. The business must derive less than forty percent of its gross income from dividends, interest, royalties (other than mineral, oil or gas royalties, or copyright royalties) and annuities, and

7. The business reports at least twenty-five hundred dollars in gross income in any taxable year.

Section 612(p) contains no requirement that a corporation which is to qualify as a new business must be subject to tax under Article 9-A of the Tax Law. Accordingly, an investment in an S corporation may qualify for the new business investment deferral.

Additionally, Petitioner asserts that investment in S corporations should not be excluded from the benefits afforded by section 612(o). Petitioner argues that ". . .it appears as if the legislature did not intend to exclude investments in S corporations from qualification, but just never considered the issue since S corporations did not exist at the time of enactment".

It is noted that section 660 of the Tax Law and 612(o) of the Tax Law were both enacted by Chapter 103 of the Laws of 1981. It is apparent from a reading of the Governor's Approval Memorandum that sections 660 and 612(o) were two elements of a single plan to provide "targeted tax reductions and innovative investment incentives to assure continued economic growth in the state . . . ." (New York Legislative Annual 1981, p. 81.). As such, it must be presumed that the Legislature was aware of the interplay of the two provisions and intended the result achieved by the provisions of the statute.

DATED: October 20, 1987

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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