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

TSB-A-92 (2) C
Corporation Tax
January 31, 1992

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C910912A

On September 12, 1991, a Petition for Advisory Opinion was received from Kenneth T. Zemsky, Ernst & Young, 277 Park Avenue, New York, New York 10172.

The issue raised by Petitioner, Kenneth T. Zemsky, is how to compute entire net income with respect to the rules relating to acceleration of deferred gain under two proposed scenarios.

Corporation X is a New York corporation and is owned by Corporation Y, a non-taxpayer. For federal income tax purposes, Corporation X and Corporation Y file on a consolidated basis. During 1991, Corporation X stopped its operations and sold its operating assets. Corporation X will have a net operating loss for 1991.

Corporation X's remaining assets include two purchase money notes originating from the sale of real property in New York City in 1982. The property was used in Corporation X's operations. The sale was essentially treated as an installment sale with no recognized gain in 1982, but substantial gains will be recognized when the notes mature in 1992 and 1997. The 1992 maturing note may be redeemed in 1991.

Corporation X also owns two parcels of land, one of which is located in New York State.

Scenario #1: A non-New York holding company is established between Corporation X and Corporation Y and is included in Corporation Y's federal consolidated return. Corporation X will dividend the notes to the new holding company.

Questions:

1. Would Corporation X be required to currently recognize the entire gain from the installment sale?

2. If no, would Corporation X be required to include the section 311 of the Internal Revenue Code (hereinafter "IRC") gain in entire net income?

3. Would ownership of the notes result in the new holding company having nexus in New York State?

Section 209.1 of the Tax Law provides that the franchise tax is imposed for all or any part of each taxable year during which a taxpayer exercises its corporate franchise. Accordingly, every taxpayer is required to pay a tax measured by its entire net income base (or other applicable basis) up to the date on which it ceases to possess a franchise.

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 and is adjusted as required by sections 208.9 and 210.3 of the Tax Law. Where a corporation participates in the filing of a consolidated return for federal income tax purposes, but files a separate return for New York franchise tax purposes, federal taxable income is computed as if the corporation had filed a separate federal return (See: Leonard Koval, CPA, Adv Op St Tax Comm, March 16, 1984, TSB-A-84(2)C.)

Section 208.9(d) of the Tax Law and section 3-2.7 of the Business Corporation Franchise Tax Regulations (hereinafter "Regulations") promulgated thereunder, provides that the Commissioner of Taxation and Finance may, whenever necessary in order to properly reflect the entire net income of a taxpayer, determine the year or period in which any item of income or deduction shall be included, without regard to the method of accounting employed by the taxpayer. Examples 2 and 3 of section 3-2.7 of the Regulations provides:

Example 2: A foreign corporation sells its New York State real estate on an installment basis, and terminates its taxable status in New York State in the year of the sale. The full profit on the sale must be included in entire net income in the year of the sale.

Example 3: A foreign corporation sells its New York State real estate on an installment basis, and terminates its taxable status in New York State in a subsequent taxable year prior to the receipt of all of its installment payments. The full profit or the remaining profit on the sale must be included in entire net income in the year it terminates its taxable status in New York State.

Herein, after Corporation X dividends the notes to the new holding company, Corporation X will not be dissolved and will continue to be a taxpayer under Article 9-A of the Tax Law. As in Koval, supra., when Corporation X computes its entire net income, its starting point is federal taxable income computed as if Corporation X had filed a separate return for federal income tax purposes.

With respect to questions i and 2, for the taxable year Corporation X dividends the notes to the new holding company, the amount of the gain computed pursuant to section 311 of the IRC will be included in the starting point for computing entire net income. Pursuant to section 208.9(d) of the Tax Law and section 3-2.7 of the Regulations, the Commissioner of Taxation and Finance, in similar situations, would exercise his authority and require that the full profit from the sale, in 1982,

of the real property located in New York City be included in Corporation X's entire net income for the taxable year in which Corporation X dividends the notes to the new holding company.

However, the Commissioner of Taxation and Finance would exercise such authority, pursuant to section 208.9(d) of the Tax Law, only with respect to an actual taxpayer, not a hypothetical corporation or taxpayer. Further, the determination of whether the Commissioner of Taxation and Finance would exercise his authority in a particular situation is a factual matter not susceptible of determination in an Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provision to "a specified set of facts." Tax Law, section 171, subd. twenty-fourth; 20 NYCRR 901.1(a).

With respect to question 3, a foreign corporation is taxable in New York State for taxable years in which it is doing business, employing capital, owning or leasing property in New York State or maintaining an office in New York State. The mere ownership of notes acquired as a dividend from Corporation X, is not sufficient to make the new holding company subject to franchise tax under Article 9-A of the Tax Law.

Scenario #2: Corporation A, a subsidiary of Corporation Y, is included in Corporation Y's federal consolidated return. Corporation X sells the notes to Corporation A. Corporation X will realize a gain upon completing this sale. The gain from this sale is deferred for federal income tax purposes.

Question:

When computing entire net income, does Corporation X recognize the gain in the year of the sale?

As in Scenario 1, Corporation X computes its entire net income by starting with federal taxable income computed as if Corporation X had filed a separate federal return. When computing the federal proforma return, the gain on the sale of the notes to Corporation A will be recognized in the taxable year of such sale, even though such gain is deferred for federal income tax purposes because of the filing of a federal consolidated return. As in Scenario 1, pursuant to section 208.9(d) of the Tax Law and section 3-2.7 of the Regulations, the Commissioner of Taxation and Finance would exercise his authority in a similar situation and require that the full profit from the sale, in 1982, of the real property located in New York City be included in Corporation X's entire net income for the taxable year in which Corporation X sells the notes to Corporation A.

Again, the Commissioner of Taxation and Finance would exercise such authority pursuant to section 208.9(d) of the Tax Law only with respect to an actual taxpayer and the determination of whether the Commissioner of Taxation and Finance would exercise his authority in a particular situation is a factual matter not susceptible of determination in an Advisory Opinion.

DATED: January 31, 1992

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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