

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

TSB-A-92 (6) C
Corporation Tax
March 23, 1992

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C920114B

On January 14, 1992, a Petition for Advisory Opinion was received from Independence Savings Bank, Atlantic Avenue and Court Street, Brooklyn, New York 11201.

The issue raised by Petitioner, Independence Savings Bank, is whether the acquisition of Petitioner, a New York chartered mutual savings bank, by a New York chartered mutual holding company and the holding company's acquisition of Long Island City Financial Corporation ("LICFC") and the merger of LICFC's subsidiary Long Island City Savings and Loan Association ("Association") with Petitioner is a tax-free transaction with respect to computing the entire net incomes of the constituent corporations under Article 2 of the Tax Law.

Petitioner is a New York State mutual savings bank subject to regulation by the New York State Banking Department (the "Department") and the Federal Deposit Insurance Corporation (the "FDIC") and joins with its subsidiaries in filing a consolidated federal income tax return. As a mutual savings bank, Petitioner has no authorized capital stock. Instead, liquidation and limited voting rights ("Petitioner equity interests") are held by the Petitioner's depositors (the depositors).

LICFC is a Delaware, publicly held, nondiversified savings and loan holding company subject to regulation by the Office of Thrift Supervision (the "OTS"). LICFC has outstanding both stock and options to acquire the stock. LICFC wholly owns Association, a New York State stock savings and loan association subject to regulation by the Department, the FDIC, and the OTS. LICFC acquired Association stock in August 1988 when Association converted to stock form. The two corporations file a consolidated federal income tax return.

To further what Petitioner and LICFC represent are valid business purposes, Petitioner proposes to acquire LICFC and Association in a transaction comprising the following steps:

- (i) Petitioner will form a New York State mutual holding company ("Parent") as a wholly owned subsidiary.
- (ii) Parent will form a New York State stock savings bank ("Sub") as a wholly owned subsidiary.
- (iii) Petitioner will merge with and into Sub pursuant to a plan of reorganization adopted on September 4, 1991 ("Merger 1"). At the time of the merger: (A) Sub will acquire substantially all of Petitioner's assets and assume all of Petitioner's liabilities; (B) all Petitioner equity interests will be exchanged for liquidation and voting rights in Parent ("Parent equity interests"), and (C) loans from and deposit accounts in Petitioner will become loans from and deposit accounts in Sub, each under the same terms and condition

as before Merger 1 except that any liquidation rights in Petitioner held before the merger will become liquidation rights in Parent. The Depositors will not have dissenters' rights in the transaction. Parent will have the option to convert to stock form, but no plan to convert exists.

- (iv) Following Merger 1, Sub will change its name to Independence Savings Bank ("ISB"). ISB will be authorized to issue voting common stock and nonvoting preferred stock to persons other than Parent and may issue this stock through a public offering or private placement. The decisions of whether, when, and how to conduct an offering or placement are subject to market and other conditions, however, and any offering or placement will likely require approval by federal and New York State regulatory agencies.
- (v) Parent will form an interim Delaware corporation ("Interim") as a wholly owned subsidiary solely to participate in step (vi) below.
- (vi) Interim will merge with and into LICFC under Delaware law, with the shareholders and option holders of LICFC receiving from Parent an aggregate of 74 million dollars in cash for their stock and an aggregate of 4 million dollars in cash for cancellation of their stock options (the "Purchase"). Of the approximately 78 million dollars in cash to be paid by Parent in the Purchase, approximately 50 million dollars will have been distributed by ISB to Parent following Merger 1, and approximately 28 million dollars will have been distributed by LICFC to Parent in the liquidation described below in step (vii).
- (vii) Following the Purchase, LICFC will be liquidated into Parent (the "Liquidation") pursuant to a plan of complete liquidation and dissolution the "Plan of Liquidation").
- (viii) Following the Liquidation, Parent will merge Association into ISB ("Merger 2").

Parent will file a consolidated federal income tax return with ISB and other subsidiaries following the above transaction provided the ownership requirements of section 1504(a) of the Internal Revenue Code (the "Code") are satisfied.

The taxpayer represents the following regarding Merger 1:

To the best of the taxpayer representatives' knowledge and belief, Merger 1 will qualify under section 368(a)(1)(A) and (a)(2)(D) of the Code.

The taxpayer represents the following regarding the Purchase:

- (a) The terms of the merger agreement among Parent, ISB, LICFC, and Association are the result of arm's-length negotiations among unrelated parties, and the purchase price of the LICFC stock set forth in the merger agreement and paid by Parent to the stockholders of LICFC will be approximately equal to the fair market value of the stock on the date of purchase.

- (b) Parent will acquire (within the meaning of section 338(h)(3) of the Code) 100 percent of the LICFC stock in the Purchase.
- (c) Before the Purchase, no shareholder or group of shareholders of LICFC, through actual or constructive ownership, will be in control of Interim, Parent, or ISB as the term "control" is used in section 304(c) of the Code.
- (d) Before the Purchase, no shares of stock of LICFC or a LICFC affiliate (as defined in section 338(h)(6) of the Code) will be owned (either actually or constructively within the meaning of section 318(a)) by Parent, Interim, ISB, or a member of any affiliated group (as defined in section 338(h)(5)) of which Parent or ISB is a member.
- (e) Parent will not elect under section 338(g) of the Code to have the Purchase treated as a deemed purchase of assets. Each member of Parent's affiliated group (as defined in section 338(h)(5)) will join in filing a protective carryover basis election pursuant to section 1.338-4T(f)(6) of the Temporary Income Tax Regulations.
- (f) Parent will acquire the LICFC stock solely for cash.
- (g) LICFC repurchased 67,563 shares of its stock between February 27, 1989 and September 11, 1989, and repurchased 49,500 shares between January 7, 1991 and February 21, 1991. These repurchases of stock are not related to the present transaction. Other than these repurchases, there will have been no redemptions of LICFC stock within the 3-year period preceding the date on which Parent will purchase the LICFC stock and the date on which LICFC will adopt the Plan of Liquidation.
- (h) There is no plan to liquidate Parent.
- (i) Parent, Interim, LICFC, Association, and the shareholders and option holders of LICFC each will pay its, his, or her expenses, if any, incurred in the Purchase.
- (j) No part of the consideration to be received by any stockholder of LICFC will be received as a debtor, creditor, employee, or in any capacity other than as a stockholder of LICFC.
- (k) No assets of LICFC, Association, or a target affiliate (as defined in section 338(h)(6) of the Code) have been or will be acquired within the consistency period (as defined in section 338(h)(4)) by Parent, ISB, or a member of Parent's affiliated group (as defined in section 338(h)(5)), except for assets acquired pursuant to a sale by LICFC or Association in the ordinary course of business or where the asset acquired from LICFC or Association has a basis determined wholly by reference to the adjusted basis of the asset in the hands of LICFC or Association.

- (l) Interim will be formed solely for purposes of completing the proposed transaction. Before the Purchase, Interim will conduct no business and have no income or operating assets, and its separate existence will cease upon completion of the Purchase.
- (m) Before and after the Purchase, there will be no intercorporate debt existing between or among Parent, Interim, IB, LICFC, and Association, and none has ever been cancelled, forgiven, or discounted.

The taxpayer represents the following regarding the Liquidation:

- (n) Parent, on the date of adoption of the Plan of Liquidation, and at all times until the final liquidating distribution by LICFC is completed, will be the owner of 100 percent of the single outstanding class of LICFC stock.
- (o) All distributions from LICFC to Parent pursuant to the Plan of Liquidation will be made within a single taxable year of LICFC.
- (p) As soon as the first liquidating distribution has been made, LICFC will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to Parent.
- (q) LICFC will retain no assets following the final liquidating distribution.
- (r) LICFC will not have acquired assets in a nontaxable transaction at any time, except for acquisitions occurring more than 3 years before the date of adoption of the Plan of Liquidation.
- (s) No assets of LICFC have been, or will be, disposed of by either LICFC or Parent, except for dispositions in the ordinary course of business and dispositions occurring more than 3 years before adoption of the Plan of Liquidation.
- (t) The Liquidation will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation ("Recipient") of any of the business or assets of LICFC if persons holding, directly or indirectly, 20 percent or more in value of the LICFC stock also hold, directly or indirectly, more than 20 percent in value of the Recipient. For purposes of this representation, ownership will be determined by the application of the constructive ownership rules of section 318 of the Code, as modified by section 304(c)(3) of the Code.
- (u) Before adoption of the Plan of Liquidation, no assets of LICFC will have been distributed in kind, transferred, or sold to Parent, except for (i) transactions occurring in the normal course of business, and
 - (ii) transactions occurring more than 3 years before adoption of the Plan of Liquidation.

- (v) LICFC will report all earned income represented by assets that will be distributed to Parent such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
- (w) The fair market value of the assets of LICFC will exceed its liabilities both at the date of adoption of the Plan of Liquidation and immediately before the time the first liquidating distribution is made.
- (x) Neither Parent nor ISB is an organization that is exempt from federal income tax under section 501 or any other provision of the Code.
- (y) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed liquidation of LICFC have been fully disclosed.

In a letter ruling dated January 10, 1992, the Internal Revenue Service has concluded as follows regarding Merger 1, the Purchase, the Liquidation, and Merger2:

Rulings (1), (2), and (3) pertain to significant subissues of Merger 1 (see section 3.0125 of Rev. Proc. 91-3, 1991-1 C.B. 364, 367):

(1) The distribution of 50 million dollars by ISB to Parent (described above in step (vi)) will be disregarded in determining whether the "substantially all" requirement of section 368(a)(2)(D) of the Code has been satisfied in Merger 1.

(2) The requirement under section 368(a)(2)(D) of the Code that properties be acquired "in exchange for stock" of the controlling corporation will be treated as satisfied in Merger 1.

(3) The exchange of Petitioner equity interests for Parent equity interests in Merger 1 will satisfy the continuity of interest requirement of section 1.368-1(b) of the Income Tax Regulations (see Rev. Rul. 78-286, 1978-2 C.B. 145 (exchange of deposit accounts in merger of mutual savings banks satisfies continuity requirement); Rev. Rul. 69-3, 1969-1 C.B. 103 (same for passbooks in mutual savings and loan merger); see also Paulsen v. Commissioner, 469 U.S. 131, 142 (1985) (dictum).

(4) For federal income tax purposes, the 28 million dollars in cash distributed by LICFC to Parent in the Liquidation (described above in step (vii)) and then used by Parent in the Purchase (described above in step (vi)) will be treated instead as passing directly from LICFC to the stockholders and option holders of LICFC, 24 million dollars being distributed pro rata among the stockholders in redemption of an equivalent fair market value of LICFC stock and 4 million dollars being paid in cancellation of all outstanding options.

(5) The formation of Interim, the merger of Interim into LICFC, and the simultaneous conversion of Interim stock to LICFC stock will be disregarded for federal income tax purposes, and the transaction will be treated instead as a direct purchase by Parent for cash of LICFC stock not treated as redeemed in ruling (4) (the "Purchased Stock") (Rev. Rul. 90-95, 1990-2 C.B. 67, and Rev. Rul. 73-427, 1973-2 C.B. 301).

(6) Parent's acquisition of the Purchased Stock will be a "qualified stock purchase" within the meaning of section 338(d)(3) of the Code (Question and Answer 3 of section 1.338-4T(d) of the Temporary Regulations).

(7) Parent, LICFC, and Interim will recognize no gain or loss on Parent's acquisition of the Purchased Stock (Rev. Rul. 90-95 and Rev. Rul. 73-27).

(8) As provided in section 1001 of the Code, gain or loss will be recognized by each LICFC shareholder upon the receipt of cash in return for Purchased Stock, as described above in ruling (5), in an amount measured by the difference between the cash received and the LICFC shareholder's adjusted basis (as determined under section 1011) in the stock surrendered. Provided section 341 is not applicable and the stock of LICFC surrendered for cash qualifies as a capital asset in the shareholder's hands, the gain or loss will be capital gain or loss, subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.

(9) The 24 million dollars in cash treated under ruling (4) as paid directly to LICFC stockholders in redemption of LICFC stock will be subject in each case to the provisions and limitations of section 302 of the Code. Moreover, these redemptions and the purchase of LICFC stock described above in ruling (5) will be treated for purposes of section 302(b) as parts of an overall plan to reduce each shareholder's interest in LICFC (Rev. Rul. 75-447, 1957-2 C.B. 113).

(10) For federal income tax purposes, LICFC's statutory merger into Parent will be treated as a complete liquidation within the meaning of section 332(a) of the Code (section 1.332-2(d) of the regulations).

(11) LICFC will recognize no gain or loss upon distribution of all its assets to, and the assumption of all its liabilities by, Parent in complete liquidation (sections 336(d)(3) and 337(a)).

(12) Parent will recognize no gain or loss on receipt of the LICFC assets (excluding the 28 million dollars of cash treated under ruling (4) as distributed by LICFC directly to its shareholders and option holder) distributed pursuant to the Plan of Liquidation, provided all the requirements of section 332(b) are met (section 332(a)).

(13) Parent's basis in each LICFC asset to be received in the Liquidation will be the same as the basis of that asset in the hands of LICFC immediately before the Liquidation (section 334(b)(1)).

(14) Parent's holding period for each LICFC asset to be received in the Liquidation will include the period during which that asset was held by LICFC (section 1223(2)).

(15) Parent will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of LICFC as of the effective date of the Liquidation (section 381(c)(2); section 1.381(c)(2)-1 of the regulations). Any deficit in earnings and profits of LICFC will be used only to offset earnings and profits accumulated after the date of transfer.

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(16) Parent will succeed to and take into account the items of LICFC described in section 381(c) of the Code (section 381(a); section 1.381(a)-1 of the regulations). These items will be taken into account by Parent subject to the provisions and limitations of sections 381, 382, and 383.

Ruling (17) pertains to a significant subissue of Merger 2 (see section 3.0125 of Rev. Proc. 91-3):

(17) The Purchase and the Liquidation will not prevent Merger 2 from satisfying the continuity of interest requirement of section 1.368-1(b) of the regulations.

Section 1451 of Article 32 of the Tax Law imposes, annually, a franchise tax on every banking corporation for the privilege of exercising its franchise or doing business in New York State in a corporate or organized capacity.

Section 1455(a) of the Tax Law provides that the basic tax is nine percent of the taxpayer's entire net income, or portion thereof allocated to New York State, for the taxable year or part thereof.

Entire net income is defined in section 1453(a) of the Tax Law as "total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income). . . which the taxpayer is required to report to the United States treasury department, . . . subject to the modifications and adjustments hereinafter provided."

Section 1453(b) through (k) of the Tax Law and sections 18-2.3, 18-2.4 and 18-2.5 of the Franchise Tax on Banking Corporations Regulations, promulgated thereunder, provide for the modifications and adjustments required by section 1453(a). However, there is no modification or adjustment applicable to a transaction where, for federal income tax purposes, a Reorganization is treated as an exchange pursuant to section 368(a)(1)(A) and (a)(2)(D) of the Code and will result in no recognition of gain or loss for federal income tax purposes. Therefore, for purposes of section 1453 of the Tax Law, such transaction would be treated the same as it is treated for federal income tax purposes.

Accordingly, if Petitioner's transaction described herein involving Petitioner, Parent, ISB, LICFC and Association is treated as a reorganization that is a tax-free exchange under sections 368(a)(1)(A) and (a)(2)(D) of the Code, such exchange would be tax-free for purposes of computing entire net income under section 1453 of Article 32 of the Tax Law.

DATED: March 23, 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.