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

TSB-A-98(20)C
Corporation Tax
November 3, 1998

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C980626A

On June 26, 1998, a Petition for Advisory Opinion was received from Arthur Andersen LLP, 400 Atlantic Street, Stamford, Connecticut 06912.

The issue raised by Petitioner, Arthur Andersen LLP, is whether the sale of the target corporation in a section 338(a) of the Internal Revenue Code transaction represents a disposition of assets requiring recapture of the target corporation's investment tax credit carryover which was previously claimed under section 210.12 of the Tax Law,.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Corporation X is a wholly owned subsidiary of Seller. Seller intends to sell its shares of Corporation X to an unrelated third party ("Buyer"). Both Seller and Buyer intend to make a section 338(a) of the Internal Revenue Code ("IRC") election that would treat the sale of Corporation X's shares as a deemed asset sale.

Additionally, the selling consolidated group intends to make an election under section 338(h)(10) of the IRC, whereby recognition of the gain or loss on the deemed sale of assets may be made by the selling consolidated group. The consolidated group would, therefore, be required to recognize gain or loss on the sale of Corporation X's deemed assets.

Historically, Corporation X has claimed an investment tax credit for qualifying assets purchased and placed in service in New York.

Discussion

Section 210.12(g) of the Tax Law and section 5-2.8(a) of the Article 9-A Regulations provide that if property on which investment tax credit has been claimed is disposed of or ceases to be in qualified use prior to the end of its useful life, the difference between the credit taken and the credit allowed for actual use must be added back to the tax otherwise due in the year of disposition or disqualification.

Section 5-2.8(b) of the Article 9-A Regulations provides that when a disposition occurs, the amount of investment tax credit that must be added back is computed as follows:

(1) the total number of months in qualified use of the property divided by the total number of months of useful life;

(2) multiply the amount computed in (1) by the amount of the credit claimed on the property to ascertain the credit allowed for actual use;

(3) subtract the credit allowed for actual use from the credit claimed on the property to determine the amount of investment tax credit to be added back; and

(4) add the amount to be added back to the tax due for the year the property was disposed of or ceases to qualify.

Section 5-2.8(c) of the Article 9-A Regulations provides that a disposition of qualified property includes:

(1) a sale of the property;

(2) a liquidation other than as part of a statutory merger or consolidation;

(3) a legal dissolution of the taxpayer;

(4) a trade-in of the property;

(5) a gift of the property;

(6) transfer upon foreclosure of a security interest in the property;

(7) retirement of the property before expiration of its useful life;

(8) condemnation of the property;

(9) loss of the property due to fire, theft, storm or other casualty; and

(10) transfer of the property to a corporation not taxable under article 9-A.

Section 5-2.8(e) of the Article 9-A Regulations provides that:

> [f]or purposes of this section, a disposition does not occur where property is transferred from a corporation as part of a transaction to which section 381(a) of the Internal Revenue Code applies; *e.g.*, a complete liquidation of a subsidiary under section 332 of the Internal Revenue Code, or a reorganization under section 361 and 368(a)(1)(A) (statutory merger or consolidation), section 368(a)(1)(C) (certain acquisitions of property from one corporation by another), section 368(a)(1)(D) (certain transfers of assets), section 368(a)(1)(F) (mere change in identity, form or place of organization, however effected) or section 368(a)(1)(G) (bankruptcy reorganizations). As there is no disposition in these cases, an add back is not required provided that the property continues in qualified use and is acquired by a corporation subject to tax under article 9-A. Generally, in these cases, the acquiring or surviving corporation cannot claim an investment tax credit because it takes over such property at the adjusted basis of the transferor and the transfer therefore does not qualify as a purchase pursuant to Internal Revenue Code, section 179(d)(2). If the property in the hands of the acquiring corporation is not in qualified use for its entire life or for more than 12 consecutive years, a recovery from the acquiring corporation is required. In measuring the period of qualified use, the period during which the property was held by the transferor corporation and the acquiring corporation are to be taken into account.

The term “disposition” is not defined for purposes of section 210.12(g) of the Tax Law or section 5-2.8 of the Article 9-A Regulations. It has been held that a tax-free transfer pursuant to section 351 of the IRC, that for federal income tax purposes would not require the recapture of the investment tax credit taken on IRC section 358 property, does not constitute a "disposition" as contemplated in section 210.12(g) of the Tax Law. See Coats & Clark Inc., Adv Op Comm T & F, August 11, 1988, TSB-A-88(16)C; Milton Roy Company, Adv Op Comm T F, February 10, 1993, TSB-A-93(7)C; and Morrison & Foerster LLP, Adv Op Comm T & F, December 19, 1996, TSB-A-96(27)C.

However, there is no tax-free transfer of property where a section 338(a) of the IRC election has been made. Under section 338(a) of the IRC, an election may be made by the purchaser in a qualified stock purchase, which generally involves the purchase of at least 80 percent of the stock of a corporation during any 12 month period. Pursuant to this election, the target corporation is "treated as having sold all of its assets at the close of the acquisition date at a fair market value in a single transaction." The target is then "treated as a new corporation which purchased all of the assets as of the beginning of the date after the acquisition date". The result of this election is that the difference between the fair market value of the assets and their basis is recognized as gain or loss to the old target, and the basis of the assets in the hands of the acquiring organization is stepped up or down, as the case may be. Further, for purposes of section 179(d)(2) of the IRC, section 1.179-4(c)(2) of the Treasury Regulations states that "[p]roperty deemed to have been acquired by a new target corporation as a result of a section 338 election (relating to certain stock purchases treated as asset acquisitions) will be considered acquired by purchase."

Therefore, where a section 338(a) of the IRC election is made, the assets of the target corporation are deemed sold at the close of the acquisition date at a fair market value in a single transaction, and the new target corporation is deemed to have acquired the assets by purchase for purposes of section 179(d)(2) of the IRC, with the basis of the assets stepped up or down, as the case may be. Accordingly, this transaction would constitute a disposition as contemplated under section 5-2.8(e) of the Article 9-A Regulations, and the new target corporation may be allowed to claim an investment tax credit if the property otherwise qualifies under section 210.12 of the Tax Law.

Pursuant to Technical Services Bureau Memorandum, TSB-M-91(4)C, April 17, 1991, for purposes of Article 9-A of the Tax Law, a section 338(h)(10) of the IRC election is ignored in all cases, and the transaction is treated as if only a section 338(a) of the IRC election were made, determined as if the seller and the target corporation filed separately for federal income tax purposes. However, in a typical situation, the target corporation will be filing only two reports, a final short year of old target and the first short year as new target.

When determining the target corporation's federal taxable income as if it had filed separately for federal income tax purposes, a gain (or loss) on the deemed sale of the target's assets under a section 338(a) of the IRC election would be included in old target's final return. For purposes of Article 9-A of the Tax Law, gain (or loss) on the deemed sale of the target's assets would be included on the old target's final return and the old target would also be required to recapture the investment tax credit. When the target files as new target, it would have a stepped up (or stepped down) basis for the assets and could claim an investment tax credit if the property otherwise qualifies under section 210.12 of the Tax Law. (See, Technical Services Bureau Memorandum, TSB-M-86(3)C, April 3, 1986.)

In this case, Corporation X, as a result of the section 338(a) of the IRC election, will be deemed to have disposed of its assets pursuant to section 5-2.8(c) of the Article 9-A Regulations. For purposes of Article 9-A of the Tax Law, the section 338(h)(10) of the IRC election will be disregarded. Corporation X will be required to file two short period returns. One will be the final return of old target as of the close of the acquisition date, and one will be as the new target. The starting point for computing entire net income for both returns will be Corporation X's federal taxable income computed as if it had filed separately for federal income tax purposes. Accordingly, when Corporation X files its final return as old target corporation, it will include in the computation of entire net income, any deemed gain (or loss) on the deemed sale of the assets, and it must add back to the tax due the amount of investment tax credit that must be recaptured pursuant to section 5-2.8(b) of the Article 9-A Regulations. To the extent that the amount to be recaptured is a carryover of a credit that was allowed for a taxable year but not deductible, the carryover will cease, and will not be allowed to be carried over the first year of the new target corporation. Corporation X, as new target, may be able to claim an investment tax credit if the property qualifies under section 210.12 of the Tax Law.

DATED: November 3, 1998

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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