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

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Corporation Tax
TSB-A-09(4)I
Income Tax
May 13, 2009

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. Z081208A

The petitioner, [redacted] ("Petitioner"), asks whether its tangible property component of the Brownfield Redevelopment Tax Credit may be specially allocated among Petitioner's members in the same proportion as the depreciation deductions relating to the qualified tangible property that gives rise to the tax credit are allocated in the tax year the qualified tangible property is placed in service.

We conclude that the special allocation of the tangible property component of the Brownfield Redevelopment Tax Credit that is based on Petitioner's special allocation of the depreciation deductions between its members is valid, provided that the special allocation of the depreciation deductions has substantial economic effect.

Facts

Petitioner is a New York limited liability company classified as a partnership for Federal and New York tax purposes. Substantially all of the interests in Petitioner are owned by other limited liability companies. All of the members of those other limited liability companies are individuals or trusts subject to New York personal income tax, or are corporations subject to New York corporation franchise tax.

Petitioner is currently a party to a Brownfield Site Cleanup Agreement with the New York State Department of Environmental Conservation ("DEC") to remediate and redevelop a qualified site. The DEC issued a notice to Petitioner that its request for participation in the Brownfield Cleanup Program had been accepted. The DEC issued a Certificate of Completion ("COC") to Petitioner prior to June 23, 2008, so that the amendments made by Chapter 390 of the Laws of 2008 to Tax Law section 21 do not apply. Petitioner has not yet placed into service qualified tangible property that will give rise to a portion of the tax credits, but expects to do so during tax years 2009 and 2010, or a date no later than ten years from the date of the issuance of the COC.

Petitioner anticipates that a new member ("Investor"), which is likely to be a business entity classified as a corporation for Federal and New York corporation tax purposes, will make a cash contribution to the capital of Petitioner before the qualified tangible property is placed in service. In exchange for the capital contribution, Investor will receive through 2014, a 5% interest in the profits and losses of Petitioner. Thereafter, Investor will have a .01% interest in the profits and losses of Petitioner. For 2009 and 2010, Petitioner plans on allocating 99.99% of the depreciation deductions with respect to qualified tangible property and the tangible property component of the Brownfield Redevelopment Credit to Investor. The remaining .01% will be allocated to the existing members of Petitioner. It is Petitioner's position that the special allocation of the depreciation deductions for tax years 2009 and 2010 will have substantial economic effect for Federal tax purposes.

Analysis

Although some credits (e.g. QEZE real property and tax reduction credits and the film production credit) reference a partner's "pro rata share," this is not a defined term in the statute. Other than these instances, the Tax Law does not contain any specific explanation on how to allocate New York State credits.

The regulations under Article 9-A state that the general rule for the computation of tax under the aggregate method for corporate partners is that a taxpayer's distributive share (as that term is defined in section 704 of the Internal Revenue Code) of each partnership item of receipts, income, gain, loss and deduction and the taxpayer's proportionate part of each partnership asset and liability and each partnership activity shall have the same source and character in the hands of the partner for Article 9-A purposes as that item has in its hands for federal income tax purposes. (See, 20 NYCRR §3-13.3(a)(1).)

Section 704 of the IRC defines a partner's distributive share, in relevant part, as follows:

> (a) Effect of Partnership Agreement. – A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this chapter, be determined by the partnership agreement.
>
> (b) Determination of Distributive Share – A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if –
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>> (1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or
>>
>> (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) *does not have substantial economic effect* (emphasis added).

The Article 9-A regulations also provide that an allocation of an item, amount, or activity, even if recognized for Federal income tax purposes, will not be recognized when its principal purpose is the avoidance or evasion of any tax imposed on the taxpayer. Where an allocation is not recognized, the taxpayer's distributive share will be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances). The regulation then describes the circumstances to be considered in determining whether a principal purpose of an allocation of an item, amount or activity is the avoidance or evasion of any tax imposed on the taxpayer. Among the relevant circumstances are whether the allocation has substantial economic effect, and whether the related items of partnership income, gain, loss and deduction from the same source are subject to the same allocation. (See, 20 NYCRR § 3-13.3(a)(3)).

For federal income tax purposes, a special allocation of a tax credit may be allowed if the sole component in the calculation of the tax credit is a partnership *expenditure* and that partnership *expenditure* has a valid special allocation of loss or deduction (or other downward capital account adjustments) in the partnership's tax year, so that the partners' interests in the partnership with respect to the credit are in the same proportion as the partners' distributive shares of loss or deduction which relate to such *expenditure*. (See, Treas. Reg. § 1.704-1(b)(5), example (11)).

While the Article 9-A regulations do not specifically cover the proper allocation of a New York State tax credit, it is reasonable to conform this allocation to the principles in those regulations and the federal regulatory principle on the allocation of federal tax credits. This leads to the conclusion, for purposes of this inquiry, that if a partnership expenditure is the sole component in the calculation of the New York tax credit and the New York tax credit is allocated in the same way as that *expenditure* is allocated among the partners, the allocation of the New York tax credit is valid if it does not have as a principal purpose the avoidance or evasion of any tax imposed on the taxpayer, and the allocation of the *expenditure* has substantial economic effect.

According to the facts provided by Petitioner and the LLC agreement, Investor has a 5% interest in the profits and losses of Petitioner through 2014 and thereafter Investor will have a 1% interest in the profits and losses. However, Investor will be allocated 99.99% of the tangible property component of the Brownfield Redevelopment Tax Credit and the depreciation deductions with respect to such property for tax years 2009 and 2010. The tangible property credit component is equal to the applicable percentage of the cost or other basis for federal income tax purposes of tangible personal property and other personal property, including buildings and structural components of buildings, which constitute qualified tangible property. (See, Tax Law §21(a)(3)). Thus, because the calculation of Petitioner's tangible property credit component is based solely on the cost or other basis in the property for federal income tax purposes and the depreciation deduction for such property also relies on the property's federal basis, the credit allocation is following the expenditure allocation. In the Internal Revenue Service Chief Counsel Advice (CCA 200812023), the Internal Revenue Service concluded that the section 42 low income housing tax credit could be allocated in the same proportion as the special allocation of the partnership's depreciation deduction. The position in this Chief Counsel Advice is consistent with 26 C.F.R. § 1.704-1(b)(5) example 11(i) and (ii).

Accordingly, if Petitioner's special allocation of 99.99% of the depreciation deductions to Investor has substantial economic effect and is valid for federal and state tax purposes, then the same allocation of the tangible property component of the Brownfield Redevelopment Tax Credit to Investor is a valid allocation.

DATED: May 13, 2009

/S/

Jonathan Pessen
Director of Advisory Opinions
Office of 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.