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

TSB-M-86 (3)C
Corporation Tax
April 3, 1986

New York State Treatment of a Section 338 Election

General

Section 338 of the IRC was enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982. It permits a corporation which acquires the stock of another corporation, and makes a Section 338 election, to step up the basis of the assets in the newly acquired corporation to fair market value without undergoing a liquidation as previously required under Section 334(b)(2) of the IRC (repealed by TEFRA 1982).

A second set of temporary regulations (section 1-338-4T), pertaining to the Section 338 election, was adopted on April 19, 1985 by Treasury Division 8021. The length and complexity of those regulations are formidable, reflective of the complex nature of Section 338 itself. In light of this, this memorandum addresses New York State's basic adherence to the Federal treatment as outlined in their regulations, certain adjustments required as a result of a Section 338 election and the availability of certain tax credits to the acquired and acquiring corporations that are part of a Section 338 election. Detailed information should be obtained from the temporary regulation (1-338-4T).

334(b)(2) Liquidation

Under a section 334(b)(2) transaction, a corporation acquired the stock of another corporation. In order to treat such a stock purchase as a purchase of the assets of the acquired corporation, the acquired corporation had to be liquidated pursuant to Section 332 of the Internal Revenue Code within two years after the purchase of the stock. The acquired corporation (now liquidated) was required to file a cessation report covering operations to the date of liquidation. It was also required to recapture any unearned investment tax credit and depreciation.

338 Liquidation

Under Section 338, the acquired corporation is treated as both the old corporation and the newly formed subsidiary of the acquiring corporation. Where the purchasing corporation makes an election under Section 338 of the IRC, pursuant to that election, the acquired corporation is deemed to have sold all its assets in a single transaction under Section 337 at the close of the day on which eighty percent of its stock was acquired. As of the beginning of the day following the acquisition date, the acquired corporation is treated as a new corporation which has purchased the assets of the "old" corporation. The result is that the basis of the new corporation's assets are stepped-up by acquisition of its stock in the absence of a complete liquidation. However, the acquired corporation remains intact and continues its day-to-day activities.

The acquired corporation must file an election on Form 8023 with the Internal Revenue Service to be treated as a new corporation on the day following its acquisition. The acquired corporation is required to file a cessation report covering the period ended on the day it was acquired.

It will then be required to file future reports as if it were a new corporation.

New York State Treatment

Generally, New York State follows the federal treatment under Section 338. Therefore, for New York State purposes, the acquired corporation must file a cessation report to the date of liquidation. It is required to recapture any unearned investment tax credit and depreciation and recognize gain or loss in situations where the acquiring corporation does not purchase all of the stock of the acquired corporation. It then files subsequent reports as if it were a new corporation. It would then have a stepped up basis for the property and could claim an investment tax credit if the property otherwise qualifies.

In addition to the investment tax credit, the new corporation would also be eligible for the additional investment tax credit allowed under Section 210.12-A of the Tax Law, in the three taxable years subsequent to the acquisition, if its average number of employees in New York, except general executive officers, is at least 101% of its average number of employees in New York, except general executive officers, in the taxable year in which the investment tax credit was originally claimed, i.e. the first taxable year after the corporation was acquired under Section 338.

Generally, such new corporations will not qualify as a "new business" as defined in Section 210.12(j) of the Tax Law and, therefore, will not qualify for the refundable investment tax credit allowed under Section 210.12(e) of the Tax Law unless:

1. the parent corporation (owns more than 50% of the voting stock) is not a taxpayer subject to tax under Article 9-A; Sections 183, 184, 185 or 186 of Article 9; Article 32 or Article 33 of the Tax Law ; and

2. the new corporation is not similar in operation and in ownership to a business entity (or entities) taxable, or previously taxable, under Article 9-A, Sections 183, 184, 185 or 186 of Article 9, Article 32 or Article 33 of Chapter 60, or which would have been subject to tax under Article 23 (as that article was in effect on January 1, 1980 or the income (or losses) of which is (or was) includable under Article 22 of Chapter 60, whereby the intent and purpose of Section 210.12(e) and Section 210.12(j) with respect to refunding of credit to new business would be evaded; and

3. the new corporation has not been subject to tax under Article 9-A for more than four taxable years (excluding short taxable years) prior to the taxable year during which the new corporation first becomes eligible for the investment tax credit.

If the "old" corporation has been issued an initial approval of an application for certificate of eligibility for tax credits for an eligible business facility credit from the New York State Job Incentive Board prior to July 1, 1983, on or after April 1, 1983 the State Tax Commission is empowered to issue it a certificate of eligibility if it continues to meet the requirements for the eligible business facility credit. However, the State tax Commission is empowered to continue issuing certificates of eligibility <u>only if</u> the acquired corporation, the taxpayer which received initial approval for the facility, remains intact <u>and</u> continues to operate the eligible business facility.