New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(1)C
Corporation Tax
January 9, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C000626A

On June 26, 2000, a Petition for Advisory Opinion was received from Sutherland Asbill & Brennan LLP, 999 Peachtree Street, NE, Atlanta, Georgia 30309-3996.

The issues raised by Petitioner, Sutherland Asbill & Brennan LLP, are:

1. Whether a corporate member of a limited liability company ("LLC") will be able to claim its allocable share of the cost or other basis of tangible personal property for purposes of the investment tax credit ("ITC"), pursuant to section 210.12(a) of the Tax Law, and for purposes of the empire zone investment tax credit ("EZ-ITC"), pursuant to section 210.12-B of the Tax Law, where the LLC, which is classified as a partnership for federal income tax and New York franchise tax purposes, purchases and uses the tangible personal property that qualifies for the credits.

2. Whether such corporate member of the LLC qualifies as a new business pursuant to section 210.12(j) of the Tax Law, and is therefore eligible to claim a refund of the ITC, pursuant to sections 210.12(e) of the Tax Law, and the EZ-ITC, pursuant to section 210.12-B(d) of the Tax Law.

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

Organizational Structure

Parent is a publicly-traded corporation that wholly owns three subsidiaries, and is the ultimate parent company of numerous other subsidiaries. Parent's stock is widely-held, and no shareholder owns or controls, directly or indirectly, more than 10 percent of its outstanding stock. Parent and all of its direct and indirect subsidiaries that are members of its affiliated group for federal income tax purposes will be referred to collectively as the Corporate Group.

Parent has three first-tier subsidiaries: Subsidiary A, Subsidiary B, and Subsidiary C. Subsidiary C is a holding company that owns Subsidiary G, an operating paperboard and packaging company, which also owns numerous subsidiaries. From 1959 through 1971, Subsidiary G operated (either directly or through a subsidiary) a sheet plant in New York State. That facility printed and folded corrugated paper used in the production of packaging materials. That operation was discontinued in 1971, and the New York location is now used to warehouse inventory.

Subsidiary A is an operating forest products company and owns numerous subsidiaries engaged in various aspects of the forest products business. Subsidiary A at one time owned Subsidiary D, which held an interest in a limited partnership that operated an oriented strandboard plant in a foreign country. Subsidiary D has since been acquired by an unrelated forest products company.

Subsidiary A also wholly owns Subsidiary E, a holding company that owns several financial services companies. Subsidiary E (through another holding company subsidiary, Subsidiary H) and Subsidiary B, a direct holding company subsidiary of Parent, together own 100 percent of Subsidiary F, a federal savings bank. Subsidiary F owns, directly and indirectly, numerous financial services subsidiaries, including Subsidiary J and Subsidiary K, which are both engaged in the mortgage lending business.

Proposed Transaction

Parent plans to organize a new corporation, NewCo, to invest in a LLC. NewCo will be organized in Year 1. LLC will begin doing business in New York in Year 1, and NewCo will obtain its membership interest in LLC in Year 1.

NewCo will have a 50 percent or less membership interest in LLC. The remaining membership interests will be held by individuals or entities that are not related to Parent, NewCo, or any other member of the Corporate Group. LLC will be classified as a partnership for federal income tax purposes and for New York franchise tax purposes.

LLC will build, own, and operate an oriented strandboard plant in Town A, which is designated as an empire zone in New York State. LLC will enter a long-term distribution agreement with Subsidiary A, whereby Subsidiary A will commit to sell to others, or purchase for its own account, all of the oriented strandboard produced by the LLC at market prices.

Oriented strandboard ("OSB") is a structural panel which is used primarily in residential construction as a substitute for softwood plywood. OSB is manufactured by reducing logs to wood flakes approximately the size of business cards, drying the flakes, applying a small amount of waterproof resin, pressing the resinated flakes together into large sheets and then trimming the large sheets into 4 by 8 foot panels. OSB is produced from wood that is less costly, from more available wood species, and of more variable dimensions than the wood used in producing plywood.

The Corporate Group's Businesses and Operations

Subsidiary A and its subsidiaries manufacture and distribute lumber, plywood, hardboard, gypsum wallboard, particleboard, medium density fiberboard, and other building products in many states. Subsidiary G and its subsidiaries manufacture and distribute paper and packaging materials in many states. Subsidiary E's subsidiaries, Subsidiary F, and Subsidiary F's subsidiaries provide

financial services in several states. Subsidiary F's indirect subsidiaries, Subsidiary J and Subsidiary K engage in the mortgage lending business in New York State and other states. However, no member of the Corporate Group owns or operates, or (with the exception of the sheet plant operated by Subsidiary G from 1959 through 1971) has owned or operated, any manufacturing facility in New York State either directly or indirectly. Furthermore, no member of the Corporate Group is organized in New York.

The Corporate Group currently does not own or operate an OSB plant. At one time Subsidiary A owned an operating OSB plant outside of New York State. It purchased the plant in 1984, and the plant closed in 1988. Additionally, as mentioned above, Subsidiary A owned Subsidiary D, which held a 4 percent limited partnership interest in a foreign limited partnership that operated an OSB plant in a foreign country. Subsidiary D was later acquired by an unrelated forest products company. Other than the plant Subsidiary A operated from 1984 to 1988 and the small limited partnership interest owned by former Subsidiary D at one time, no member of the Corporate Group owns or operates or has owned or operated an OSB plant either directly or indirectly.

The only members of the Corporate Group that file franchise tax returns in New York State are Subsidiary A, Subsidiary G, Subsidiary J and Subsidiary K. As mentioned above, Subsidiary A and Subsidiary G both maintain some inventory in New York State. Neither Subsidiary A nor Subsidiary G has ever owned or operated any manufacturing facility in New York. Subsidiary G did operate a sheet plant that printed and folded corrugated paper used in the production of packaging materials. Subsidiary J and Subsidiary K engage in the mortgage lending business in New York and other states. Neither has ever operated any manufacturing facility in New York or any other state.

Parent is authorized to do business in New York State but has filed Form CT-245 (Maintenance Fee and Activities Return for a Foreign Corporation Disclaiming Tax Liability) for at least the last 10 years. Parent does not have any office of other place of business in New York. It does not own or lease any property, maintain inventory, or employ any other assets in New York. Parent does not perform any services in New York and does not participate in any partnership, limited liability company, or joint venture doing business in New York. Parent does not employ any persons in New York, and other than occasional meetings with stock analysts in New York, none of Parent's officers or employees perform activities for Parent or any other member of the Corporate Group in New York.

Other Representations

Town A has been designated as an empire zone pursuant to Article 18-B of the General Municipal Law, and the LLC has received a certification pursuant to Article 18-B of the General Municipal Law as a business enterprise eligible for benefits.

The tangible personal property and other tangible property, including buildings and structural components of buildings, that the LLC will place in service relating to the OSB plant, will have a

situs in an empire zone in New York State designated as such pursuant to Article 18-B of the General Municipal Law, will be depreciable pursuant to section 167 of the Internal Revenue Code (IRC), will have a useful life of four years or more, will be acquired by purchase as defined in section 179(d) of the IRC and will be principally used by the LLC in the production of goods by manufacturing. Such property will be placed in service no later than Year 5 of the LLC's existence.

Discussion

Section 209.1 of Article 9-A of the Tax Law imposes the business corporation franchise tax on every corporation, unless specifically exempt, for the privilege of exercising its franchise, or of doing business, or of employing capital, or of owning or leasing property in New York State in a corporate or organized capacity, or of maintaining an office in New York State.

An LLC that is treated as a corporation for federal income tax purposes is treated as a corporation for New York State tax purposes. An LLC that is treated as a partnership for federal income tax purposes, is treated as a partnership for New York State tax purposes. (See, FGIC CMRC Corp, Adv Op Comm T & F, April 1, 1996, TSB-A-96(11)C; and Department of Taxation and Finance Memorandum, TSB-M-94(6)I and (8)C, October 25, 1994.)

Section 3-13.2 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") provides that each partnership item of income, capital, gain, loss or deduction has the same source and character in the hands of a partner for Article 9-A purposes as it has in its hands for federal income tax purposes. Where an item is not characterized for federal income tax purposes or is not required to be taken into account for federal income tax purposes, the source and character of the item shall be determined as if such item were realized by the partner directly from the source from which realized by the partnership, or incurred by the partner in the same manner as incurred by the partnership.

Section 210.12 of the Tax Law allows an ITC against the tax imposed under Article 9-A of the Tax Law. For taxable years beginning after 1990, section 210.12 allows an ITC equal to five percent with respect to the first $350 million of the investment credit base and four percent with respect to the investment credit base in excess of $350 million. The investment credit base is the cost or other basis for federal income tax purposes of qualified tangible personal property and other tangible property, including buildings and structural components of buildings.

Under section 210.12(b) of the Tax Law and section 5-2.2 of the Article 9-A Regulations, the term "qualified property" means tangible personal property and other tangible property, including buildings and structural components of buildings, which:

(1) is acquired, constructed, reconstructed or erected by the taxpayer after December 31, 1968;

(2) is depreciable pursuant to section 167 of the IRC;

(3) has a useful life of four years or more;

(4) is acquired by the taxpayer by purchase as defined in section 179(d) of the IRC;

(5) has a situs in New York State;

(6) and is principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing.

In John J. Eagan, Norris, McLaughlin & Marcus, Adv Op St Tax Comm, April 29, 1987, TSB-A-87(9)C, it was held that where a partnership purchases tangible personal property that is principally used by the partnership and that meets all of the requirements for qualifying for the ITC, a corporate partner of the partnership is allowed an ITC, pursuant to section 210.12(a) of the Tax Law, for its allocable share of the cost or other basis of such qualifying tangible personal property. In Bruce Nadell, Adv Op Comm T&F, May 2, 1996, TSB-A-96(12)C, it was held where a corporate partner of a partnership is allowed to claim an ITC on qualifying property that is principally used by the partnership, a corporate member of an LLC that is treated as a partnership is allowed to claim an ITC on qualifying property that is principally used by the LLC.

Section 5-2.1 of the Article 9-A Regulations provides that the taxpayer must claim the ITC for the first taxable year in which the property becomes qualified property.

Section 210.12(e) of the Tax Law, provides, in part, that:

> if the amount of credit allowable under this subdivision for any taxable year reduces the tax to [the higher of the amounts prescribed in section 210.1(c) and (d) of the Tax Law] ... any amount of credit allowed for a taxable year commencing on or after to [January 1, 1987] and not deductible in such taxable year may be carried over to the fifteen taxable years next following such taxable year and may be deducted from the taxpayer's tax for such year or years. In lieu of such carryover, any such taxpayer which qualifies as a new business under [section 210.12(j) of the Tax Law] may elect to treat the amount of such carryover as an overpayment of tax to be credited or refunded in accordance with the provisions of [section 1086 of the Tax Law] ....

Section 210.12-B(a) of the Tax Law provides that a taxpayer shall be allowed an EZ-ITC against the tax imposed by Article 9-A of the Tax Law if the taxpayer has been certified pursuant to Article 18-B of the General Municipal Law. The amount of the credit shall be 10 percent of the

cost or other basis for federal income tax purposes of tangible personal property and other tangible property, including buildings and structural components of buildings, described in section 210.12-B(b), which is located within an empire zone designated as such pursuant to Article 18-B of the General Municipal Law, but only if the acquisition, construction, reconstruction or erection of such property occurred or was commenced on or after the date of such designation and prior to the expiration thereof. Section 210.12-B(b) of the Tax Law contains the conditions that must be met for tangible property to qualify for the EZ-ITC.

Section 210.12-B(e) of the Tax Law provides that property which qualifies for the ITC provided under section 210.12 of the Tax Law may be treated as property principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, viticulture or commercial fishing, provided the property otherwise qualifies under section 210.12-B(b) of the Tax Law, in which event a credit shall not be allowed under section 210.12 of the Tax Law.

Section 5-10.1(b) of the Article 9-A Regulations provides that in order to claim a EZ-ITC, a taxpayer must be certified pursuant to Article 18-B of the General Municipal Law during the taxable year, or have applied for such certification on or before the last day of the taxable year, in which the property for which the EZ-ITC is claimed becomes qualified property.

Following John Eagan, supra, and Bruce Nadell, supra, where an LLC that is treated as a partnership has been certified pursuant to Article 18-B of the General Municipal Law, and it purchases tangible property that is principally used by the LLC and that meets all of the requirements under section 210.12-B of the Tax Law for qualifying for the EZ-ITC, a corporate member of the LLC is allowed an EZ-ITC, pursuant to such section 210.12-B, for its allocable share of the cost or other basis of such qualifying tangible property. Where the corporate member of the LLC claims the EZ-ITC under section 210.12-B of the Tax Law, pursuant to section 210.12-B(e) of the Tax Law it may not claim an ITC under section 210.12 of the Tax Law.

Section 210.12-B(d) of the Tax Law provides that the EZ-ITC allowed for any taxable year shall not reduce the tax due for such year to less than the higher of the amounts prescribed in section 210.1(c) and (d) of the Tax Law. However, if the amount of the EZ-ITC allowed for any taxable year reduces the tax to such amount, any amount of EZ-ITC not deductible in such taxable year may be carried over to the following year or years and may be deducted from the taxpayer's tax for such year or years. In lieu of such carryover, any such taxpayer which qualifies as a new business under section 210.12(j) of the Tax Law may elect, on its report for its taxable year with respect to which the EZ-ITC is allowed, to treat 50 percent of the amount of such carryover as an overpayment of tax to be credited or refunded in accordance with the provisions of section 1086 of the Tax Law.

Section 210.12(j) of the Tax Law defines a "new business" as any corporation except:

1. a corporation in which over 50 percent of the number of shares of stock entitling their holders to vote for the election of directors or trustees is owned or

controlled, either directly or indirectly, by a taxpayer subject to tax under Article 9-A; section 183, 184, 185 or 186 of Article 9; Article 32 or 33 of the Tax Law; or

2. a corporation that is substantially similar in operation and in ownership to a business entity or entities taxable, or previously taxable under Article 9-A; section 183, 184, 185, or 186 of Article 9; Article 32 or 33; or Article 23 or that would have been subject to tax under Article 23, as such article was in effect on January 1, 1980, or the income (or losses) of which is (or was) includable under Article 22 of the Tax Law whereby the intent and purpose of sections 210.12(e) or 210.12B(d) of the Tax Law with respect to refunding of credit to new business would be evaded; or

3. a corporation that has been subject to tax under Article 9-A for more than four years (excluding short periods) before each tax year during which the taxpayer becomes eligible for the ITC or EZ-ITC (that is, the year for which the credit is allowed).

Chapter 103 of the Laws of 1981, created the refundable ITC at issue. A review of the legislative history discloses that this law was intended to accomplish the following: "It expands and enriches various investment incentives to assure continued economic growth in the State" (Memorandum In Support, Governor's Bill Jacket, L 1981, ch 103). The Budget Report Memorandum (Governor's Bill Jacket, L 1981, ch 103) noted the following "brief recapitulation" of the sessions law: "To encourage business investments in New York State by liberalizing and increasing certain investment incentives and credits under the corporate franchise and personal income taxes." (See also, International Imaging Materials, Inc, Dec Tax App Trib, TSB-D-95(4)C, June 8, 1995.)

The settled purpose of the statute at issue was to encourage business investments in New York State. An expansive interpretation of "substantially similar operations", without regard to whether such substantially similar operations were conducted by a company related to the taxpayer in New York, would defeat such purpose. (cf., Symphony Space v Tishelman, 60 NY2d 33; Brooklyn Union Gas v Commr of Dept of Fin., 108 AD2d 74, revd on other grounds 67 NY2d 1036). Therefore, in order to give effect to the Legislature's purpose, the statute should be interpreted so that a refundable ITC would not be disallowed to a taxpayer related to a corporation that had conducted substantially similar operations outside of New York State. See Scepter, Inc., Adv Op, Comm T&F, April 7, 1999, TSB-A-99(18)C.

Conclusion

In this case, Petitioner states that the LLC's tangible personal property and other tangible property, including buildings and structural components of buildings relating to the OSB plant that the LLC places in service will be property that will qualify for the ITC under section 210.12 of the Tax Law and EZ-ITC under section 210.12-B of the Tax Law. Therefore, NewCo, as a corporate member of the LLC, may claim either the ITC or the EZ-ITC for its allocable share of the cost or other basis for the qualifying tangible property used by the LLC. However, pursuant to section 210.12-B(e) of the Tax Law, NewCo can not claim both the ITC and the EZ-ITC. Therefore, NewCo will be allowed the ITC under section 210.12 of the Tax Law, unless it elects to claim the EZ-ITC pursuant to section 210.12-B(e) of the Tax Law.

In either event, NewCo will meet the conditions of section 210.12(j) of the Tax Law to be treated as a new business for the following reasons.

1. NewCo is not a corporation owned or controlled, either directly or indirectly by a taxpayer subject to tax under Article 9, 9-A, 32 or 33 of the Tax Law. Parent is not a taxpayer.

2. NewCo will be similar in ownership to a business entity taxable under Article 9-A. Parent directly owns Subsidiary A, a taxpayer under Article 9-A. Parent also indirectly owns Subsidiary G, a taxpayer under Article 9-A and Subsidiary J and Subsidiary K, taxpayers under either Article 9-A or 32. However, based on legislative history and Scepter Inc, supra, it is determined that NewCo will not be similar in operation to these entities. Subsidiary A's activities in New York State currently consist of warehousing inventory in New York. In the past, Subsidiary A's activities included the operation of an OSB plant outside of New York, and indirectly holding an interest in a limited partnership that operated an OSB plant in a foreign country. Subsidiary G's activities in New York State currently consist of warehousing inventory in New York, and in the past, included the operation of a sheet plant. Subsidiary J and Subsidiary K activities in New York involve the mortgage lending business. NewCo's principal business activity is operating an OSB plant in New York. While Subsidiary A's former activities of operating an OSB plant are similar to NewCo's activities, such activities by Subsidiary A were not conducted in New York State. None of the activities of the other entities involve the operation of an OSB plant.

3. NewCo began doing business in New York State in Year 1, when the LLC began business. The LLC will put the qualifying property into service no later than Year 5 of the LLC's existence. Therefore, Petitioner will not be a corporation that is subject to tax under Article 9-A for more than four years prior to the year during which NewCo first becomes eligible for the investment tax credit.

Accordingly, NewCo may not claim both the ITC and the EZ-ITC. If NewCo claims the ITC under section 210.12 of the Tax Law, on qualifying property of the LLC placed in service no later than Year 5, NewCo will be a new business and may claim a refund of such ITC pursuant to section 210.12(e) of the Tax Law. However, if NewCo claims the EZ-ITC under section 210.12-B of the Tax Law, on qualifying property of the LLC placed in service no later than Year 5 of the LLC's existence, NewCo will be a new business and may claim a partial refund of such EZ-ITC pursuant to section 210.12-B(d) of the Tax Law.

DATED: January 9, 2001

/s/
Jonathan Pessen
Tax Regulations Specialist III
Technical Services Division

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