New York State Department of Taxation and Finance Office of Counsel

TSB-A-20(3)C
Corporation Tax
February 11, 2020

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

The Department of Taxation and Finance received Petitions for an Advisory Opinion from [REDACTED] ("CoA"), [REDACTED] and [REDACTED] ("CoB") [REDACTED] (collectively, "Petitioners"), which will be treated as a joint petition since each petitioner requests an opinion regarding the tax effects of the same transactions.

For purposes of Tax Law Article 9-A, Petitioners ask two questions:

(1) If the structure of a sale by CoA of the entirety of the issued and outstanding stock of CoB to an unrelated third party conforms to the provisions of Internal Revenue Code ("IRC") § 338(h)(10), will New York follow the federal tax treatment of said sale?
(2) If a distribution by CoB to CoA of certain assets prior to the sale conforms with IRC § 338(h)(10), will New York follow the federal tax treatment of said distribution?

The Department concludes in the affirmative for both questions. These conclusions are limited to the Tax Law as it existed for the years beginning before January 1, 2015.

Facts[1]

[REDACTED] ("CoC") is a New Jersey corporation. Prior to December 30, 2013, CoC owned all of the issued and outstanding stock of [REDACTED] ("CoD"), a Delaware corporation, and CoA, a Pennsylvania corporation. CoA owns 100 percent of the issued and outstanding stock of CoB, a New York corporation. CoB owns the entirety of the issued and outstanding stock of [REDACTED]. ("CoE"), a New Jersey corporation. CoB also wholly-owned [REDACTED] ("CoF"), a Delaware limited liability company treated as a disregarded entity for federal income tax purposes.

On December 30, 2013, CoD merged with and into CoF, after which CoF was the sole surviving entity ("the Merger"). CoF continued to be solely owned by CoB.

During the tax year ending December 31, 2014, CoA sold the stock of CoB to an unrelated buyer ("Buyer") for cash (the "Sale") and both parties intended the structure of the Sale to align with the provisions of IRC § 338(h)(10). For purposes of the Sale, CoC, CoA, CoB and Buyer agreed to undertake the following transactions accomplished at about the same time as the Merger: (1) CoB distributed to CoA all of CoB's stock in CoE, CoB's membership interest in CoF and certain other assets and liabilities ("Unwanted Assets") pursuant to a formal plan of liquidation entered into before this distribution ("The Distribution"); (2) Buyer purchased all of the issued and outstanding stock of CoB for cash; and (3) CoA and Buyer jointly elected to follow the provisions of IRC § 338(h)(10) with respect to the Sale. After the Sale, CoC continued to own CoA, CoA continued to own CoE and CoA was the sole member in CoF.

[1] The "Facts" include information provided by Petitioners after their filing of their respective petitions.

For the tax year ending December 31, 2014, for federal income tax purposes, CoC, CoA, CoB and CoE filed as part of a federal consolidated group. For that same year, CoB filed a New York franchise tax return pursuant to Article 9-A, separately from the other members of its federal consolidated group.[2] CoA did not file a New York franchise tax return for the tax year ending December 31, 2014. It is assumed that CoC and CoE also did not file New York franchise tax returns for that same tax year.

Analysis

Since, under the facts presented, CoA did not file a New York franchise tax return, the analysis herein will concentrate on CoB's potential tax liability under Article 9-A.

CoB is subject to an annual franchise tax in New York (*See* Tax Law § 209[1]). That tax is imposed on the highest of several different bases (*See* Tax Law § 210[1]), which, as relevant here, will be CoB's entire net income base, *i.e.*, its entire net income allocated to New York. CoB's starting point for computing its pre-allocation entire net income is presumed to be its federal taxable income (*See* Tax Law § 208[9]).

As previously analyzed by the Department (*See McDermott, Will & Emery*, TSB-A-02[1]C [April 2, 2002], TSB-A-11[3]C [February 18, 2011]; *see also Roger Cukras*, *Hutton Ingram Yuzek Carroll & Bertolotti*, *LLP*, TSB-A-99[22]C [September 14, 1999]), IRC § 338(a) provides an election to the parties to a qualified sale of stock in a target company by which they may treat that sale as a sale of assets by the target as of the close of the date of the qualified stock sale ("old target"). This IRC § 338(a) election also allows the parties to treat the target as a new corporation ("new target") that purchased the entirety of those same assets at the beginning of the following day (*see* TSB-A-02[1]C, TSB-A-11[3]C). Old target will recognize the difference between the fair market value of the assets and the adjusted basis of the assets as a gain or loss (*id*.) That gain or loss will be reflected in the basis of the assets owned by new target (*id*.).

Assuming the IRC § 338(a) election is made and, as relevant here, the target company is a member of a selling federal consolidated group, the parties to the sale of stock in the target can make yet another election under IRC § 338(h)(10) and Treasury Reg. § 1.338(h)(10)-1(c) (*See* TSB-A-02[1]C, TSB-A-11[3]C). With this election, typically, the selling corporation's sale of stock in the target corporation can be disregarded (*See* TSB-A-02[1]C). Instead, old target will be "treated … as if … it transferred all of its assets to [the selling member] of the selling consolidated group and ceased to exist … The transfer from [old target] is characterized for Federal income tax purposes in the same manner as if the parties had actually engaged in the transactions deemed to occur … and taking into account other transactions that actually occurred or deemed to occur" (TSB-A-02[1]C *quoting* Treas. Reg. § 1.338[h][10]-1[d][4][i]).

Example 2 of Treas. Reg. § 1.338(h)(10)-1(e) further provides:

> "(i) S [*i.e.*, CoA] and T [*i.e.*, CoB] are solvent corporations. S owns all of the outstanding stock of T. S and P [*i.e.*, Buyer] agree to undertake the following transaction: T will distribute half its assets to S, and S will assume half of T's liabilities. Then, P will purchase the stock of T from S. S and P will jointly make a section 338(h)(10) election with respect to the sale of T. The corporations then complete the transaction as agreed.

[2] This opinion does not reach any conclusions regarding the proper filing status in New York of CoB or of any of its affiliates.

(ii) Under section 338(a), the assets present in T at the close of the acquisition date are deemed sold by old T to new T. Under paragraph (d)(4) of this section, the transactions described in paragraph (d) of this section are treated in the same manner as if they had actually occurred. Because S and P had agreed that, after T's actual distribution to S of part of its assets, S would sell T to P pursuant to an election under section 338(h)(10), and because paragraph (d)(4) of this section deems T subsequently to have transferred all its assets to its shareholder, T is deemed to have adopted a plan of complete liquidation under section 332. T's actual transfer of assets to S is treated as a distribution pursuant to that plan of complete liquidation" (*See* TSB-A-02[1]C).

CoA and Buyer appear to have structured the transactions described herein to align with the facts presented in Example 2.[3] If so, and if CoA and Buyer make the initial IRC § 338(a) election, Petitioners will be permitted to compute their respective amounts for federal taxable income pursuant to IRC § 338(h)(10).

The starting point for CoB to compute an amount for its entire net income is presumed to be its federal taxable income (*See* Tax Law § 208[9]). There are no statutory directives to modify entire net income to deviate from the federal tax effects of a valid IRC § 338(h)(10) election (*See* Tax Law § 208[9]; *see also* TSB-A-02[1]C). Therefore, if the Sale and the Distribution of the Unwanted Assets conform to the provisions of IRC § 338(h)(10) and the Treasury regulations promulgated thereunder, the federal tax effects of IRC § 338(h)(10) will flow through to CoB's computation of its entire net income.[4]

DATED: February 11, 2020

/S/
DEBORAH R. LIEBMAN
Deputy 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. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.

[3] The Department draws no conclusion in this Advisory Opinion as to whether the facts do align with Example 2.
[4] If CoB's Distribution of the Unwanted Assets to CoA conforms to IRC § 338(h)(10), then for federal income tax purposes, CoA would not recognize any gain or loss from the Distribution and it would have the same basis in the Unwanted Assets as CoB had (*See* TSB-A-02[1]C).