

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

TSB-A-85(25) C
Corporation Tax
October 21, 1985

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C850326A

On March 26, 1985 a Petition for Advisory Opinion was received from Techtran Systems, Inc., 200 Commerce Drive, Rochester, New York 14604.

The issues here raised are: (1) if A.D. Data, Inc. and Techtran Systems, Inc. were to join in a statutory tax free merger which was effective June 1, 1985 (pursuant to Internal Revenue Code Section 368(a)), with A.D. Data continuing as the surviving corporation, to what extent would the Techtran Systems losses incurred during fiscal year ending August 31, 1985 be available for use against the A.D. Data income earned in the fiscal year ending August 31, 1985 for the purpose of the New York State franchise tax;

(2) to what extent could the prior period net operating losses of Techtran Systems be carried forward and be used to offset the current period combined income and the combined income of future periods for the purpose of the New York State franchise tax;

(3) if A.D. Data, Inc., and Techtran Systems, Inc. were to join in a statutory tax free merger which was effective June 1, 1985 (pursuant to Internal Revenue Code Section 368(a)), with Techtran Systems continuing as the surviving corporation, to what extent would the Techtran Systems losses incurred during the fiscal year ending August 31, 1985 be available for use against the A.D. Data income earned in the fiscal year ending August 31, 1985 for the purpose of the New York State franchise tax; and

(4) to what extent could the prior period net operating losses of Techtran Systems be carried forward and be used to offset the current period combined income and the combined income of future periods for the purpose of the New York State franchise tax.

Techtran Systems, Inc., 200 Commerce Drive, Rochester, New York, (referred to herein as "Systems") is a wholly owned subsidiary of Techtran Industries, Inc., 200 Commerce Drive, Rochester, New York.

A.D. Systems, Inc., 200 Commerce Drive, Rochester, New York (referred to herein as "A.D.") is also a wholly owned subsidiary of Techtran Industries, Inc.

While both "Systems" and "A.D." join with their parent corporation, Techtran Industries, Inc. in filing a consolidated corporation income tax return (Form 1120) for Federal income tax purposes, they have historically filed separate New York franchise tax returns.

The most recent tax returns filed by these Corporations related to their respective fiscal years ending August 31, 1984.

As of August 31, 1984, "A.D." reported a New York net operating loss carryover to its fiscal year ending August 31, 1985 in the amount of \$400. In the fiscal year ending August 31, 1984, "A.D." reported a business allocation percentage of 50.70%. (The total corporate loss was \$790).

As of August 31, 1984, Systems reported a New York net operating loss carryover in the amount of \$681,025. The loss carryover is attributable to the following fiscal periods:

<u>Tax Period</u> <u>Ending</u>	<u>New York</u> <u>Net Operating Loss</u>	<u>Income Allocation</u> <u>Percentage For Period</u>
8/31/81	\$ 85,817	100%
11/30/81	54,072	100%(*)
8/31/82	212,989	100%
8/31/83	181,346	100%
8/31/84	146,801	100%

(*) The \$54,072 loss indicated from the period ending November 30, 1981 was carried over from a predecessor corporation, also called Techtran Systems, Inc. which was incorporated in Idaho, and merged on November 30, 1981 with the present Techtran Systems, Inc. The predecessor corporation also had a 100% business allocation percentage.

For the tax year ending August 31, 1985, "A.D." expects to operate at a tax profit. For the fiscal year ending August 31, 1985, "Systems" expects to continue to operate at a tax loss.

Tax Law, Section 208, subdivision 9, paragraph (f) permits a corporation subject to tax under Article 9-A a net operating loss deduction "which shall be presumably the same as the net operating loss deduction allowed under Section 172 of the Internal Revenue Code of 1954, . . . except that . . . such deduction shall not include any operating loss sustained . . . during any taxable year in which the taxpayer was not subject to the tax imposed by this Article . . .". Under the limitation of this provision, a net operating loss deduction of a survivor corporation in a merger can only embrace the net operating loss deduction sustained by the merged corporation during that portion of a taxable period when the merged corporation was subject to Article 9-A taxation.

Internal Revenue Code Section 381 provides that a corporation which acquires the assets of another corporation in certain liquidations and reorganizations, including statutory mergers and consolidations, may succeed to and take into account certain tax items of the distributor or transferor corporation, including net operating loss carryovers. Internal Revenue Code Section 381(c)(1) sets forth the rules which must be applied in determining the carryover of the transferor's loss; subparagraph (B) states:

"In determining the net operating loss deduction, the portion of such deduction attributable to the net operating loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable years as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year."

Simply stated, the carryover of the predecessor's losses to the successor's first taxable year ending after the transfer is limited to the successor's taxable income attributable to the portion of the year after the transfer.

The Internal Revenue Code does not permit a net operating loss carryback from the survivor of a merger to the merged corporation unless the merger of a wholly owned subsidiary into its parent qualifies as a liquidation under Section 332 of the Code and as a reorganization under Section 368(a)(1)(F). To qualify as an "F" reorganization, the following requirements must be met:

- (1) The shareholders and proprietary interest in the parent must not change as a result of the merger;
- (2) the transferor corporation and the acquiring corporation must be engaged in the same business activity, or integrated activities before the merger; and
- (3) the business enterprise of the survivor corporation and the merged corporation must continue unchanged after the merger.

If a survivor of a merger in an "F" reorganization wishes to carry back a net operating loss arising after the merger to a transferor corporation's pre-merger taxable years, it must show that the loss is attributable to a separate business unit or division formerly operated by the merged corporation and that the merged corporation had income in the pre-reorganization taxable years.

If the merged corporations do not qualify as an "F" reorganization net operating losses incurred by the merged corporations must be carried back three years to the corporation which incurred the loss as if the merger did not take place. If any of the losses of the merged corporations are left for carry forward, they must be applied in strict chronological order, beginning with the loss of the survivor corporation.

Accordingly, if A.D. Data, Inc. and Techtran Systems, Inc. were to join in a statutory tax free merger which was effective June 1, 1985 (pursuant to Internal Revenue Code Section 368(a)), with A.D. Data continuing as the surviving corporation, Techtran Systems' losses incurred during the

fiscal year ending August 31, 1985 would be available for use against the A.D. Data income earned in the fiscal year ending August 31, 1985 but would be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of "A.D." in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year (in this instance, $92 \div 365$ times the loss incurred by "Systems"). The amount of "Systems" operating loss remaining would be available as a carry forward to be used by "A.D." against any income earned by it in subsequent periods.

Prior period net operating losses of Techtran Systems could not be carried forward and used to offset the combined income for fiscal period ending 8/31/85, but could be applied to combined income of subsequent periods for New York State franchise tax purposes, after deduction of any current period combined loss and any loss carryover from "A.D.'s" prior fiscal years.

If A.D. Data, Inc. and Techtran Systems, Inc. were to join in a statutory tax free merger which was effective June 1, 1985 (pursuant to Internal Revenue Code Section 368(a)), with Techtran Systems continuing as the surviving corporation, Techtran Systems' losses incurred during the fiscal period ending August 31, 1985 available for use against A.D. Data income earned in the fiscal year ending August 31, 1985 would still be limited to the amount which is attributable to the portion of the taxable period after the date of merger or consolidation.

Prior period net operating losses of Techtran Systems could not be carried forward and used to offset the combined income for fiscal period ending 8/31/85. However, such prior period losses could be applied to combined income of subsequent periods. After deduction of any current period combined loss and any loss carryover from "Systems" prior periods, any loss carryover from "A.D." would be available for use.

Note that the net operating loss deduction of \$54,072 indicated from the period ending November 30, 1981, acquired from a predecessor corporation also called Techtran Systems, Inc., which was incorporated in Idaho on 1/13/81 and began business in New York State on 5/13/81 may require proration since the taxpayer was a foreign corporation beginning business in New York State, and whose first taxable period was for less than twelve months, even though the predecessor corporation had a 100% business allocation percentage.

DATED: September 9, 1985

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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