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

TSB-A-88 (16)C
Corporation Tax
August 11, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C880601B

One June 1, 1988, a Petition for Advisory Opinion was received from Coats & Clark Inc., 30 Patewood Drive, Greenville, South Carolina 29615.

The issue raised is whether the spin off of one of Petitioner's divisions into a new subsidiary, pursuant to section 351 of the Internal Revenue Code, would be considered a disposition of qualifying property under section 210.12(g) of the Tax Law and whether Petitioner would be required to recapture the investment tax credit allowed under section 210.12(a) of the Tax Law.

Petitioner is a multi-state corporation organized under the laws of the State of Delaware and is taxable under Article 9-A of the Tax Law. Petitioner has four divisions: Consumer Sewing, Industrial, Craft and Yarns and Dynacast. The first three divisions are engaged in the manufacture of yarns and threads. Dynacast is engaged in the manufacture of tooling and one of its five plants is in Yorktown, New York.

In prior years, investment tax credit was taken on the Yorktown, New York manufacturing facility. Petitioner will create a new subsidiary and spin off the Dynacast division into the new subsidiary. This transaction is not considered a sale for federal income tax purposes but is a tax-free transaction pursuant to section 351 of the Internal Revenue Code. After the transaction, all operations of the Dynacast Division, including the New York operations, will continue as they were prior to the section 351 transaction.

Section 351(a) of the Internal Revenue Code (hereinafter "IRC") states: "[n]o gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation."

Section 210.12(g) of the Tax Law and section 5-2.8(a) of the Business Corporation Franchise Tax Regulations (hereinafter "Regulations") provide that if property on which investment tax credit has been claimed is disposed of or ceases to be in qualified use prior to the end of its useful life, the difference between the credit taken and the credit allowed for actual use must be added back to the tax otherwise due in the year of disposition or disqualification.

Section 5-2.8(c) of the Regulations provides that a disposition of qualified property includes:

(1) a sale of the property;
(2) a liquidation other than as part of a statutory merger or consolidation;
(3) a legal dissolution of the taxpayer;
(4) a trade-in of the property;

(5) a gift of the property;
(6) transfer upon foreclosure of a security interest in the property;
(7) retirement of the property before expiration of its useful life;
(8) condemnation of the property;
(9) loss of the property due to fire, theft, storm or other casualty; and
(10) transfer of the property to a corporation not taxable under Article 9-A.

However, the term "disposition" is not defined for purposes of section 210.12(g) of the Tax Law or section 5-2.8 of the Regulations.

Section 1-2.1 of the Regulations provides that, unless a different meaning is clearly required, any term used in the Regulations presumably has the same meaning as when used in a comparable context in the IRC and the regulations promulgated thereunder. Herein, the language of section 210.12(g) of the Tax Law is parallel to that contained in section 47 of the IRC. Therefore, when determining whether a transaction is a disposition requiring recapture of investment tax credit for purposes of section 212.12(g) of the Tax Law and section 5-2.8 of the Regulations, it is appropriate to apply precedent set under the IRC for federal income tax purposes.

Section 47 of the IRC provides for a recomputation of the investment credit allowed by section 38 of the IRC when qualified property is disposed of or ceases to be section 38 property. In general, property will be considered disposed of whenever it is sold, exchanged, transferred, distributed, involuntarily converted, or disposed of by gift. (See S. Rep. No. 1881, 87th Cong., 2nd Sess. 149 (1962, 1962-3 C.B. 707, 852-853.) However, not all dispositions result in recapture for federal income tax purposes.

Section 1.47-3(f)(1) of the Federal Income Tax Regulations provides that the provisions of section 47 of the IRC relating to disposition do not apply to section 38 property which is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the estimated useful life which was taken into account in computing the taxpayer's qualified investment by reason of a mere change in the form of conducting the trade or business in which such section 38 property is used provided that certain conditions are satisfied. The conditions are as follows:

(a) the section 38 property must be retained as section 38 property in the same trade or business;
(b) the transferor of the section 38 property must retain a substantial interest in such trade or business;
(c) substantially all the assets (whether or not section 38 property) necessary to operate such trade or business must be transferred along with the section 38 property; and
(d) the basis of the section 38 property in the hands of the transferee must be determined in whole or in part by reference to the transferor's basis.

It has been determined that where the conditions set forth in section 1.47-3(f)(1) of the Federal Income Tax Regulations are met, a transaction qualifying for nonrecognition treatment under section 351 of the IRC constitutes a mere change in the form of conducting the trade or business and recapture of investment credit under section 47 of the IRC is not required. See Revenue Ruling 77-361 (1977-2 C. B. 6).

Accordingly, it appears that when Petitioner spins off Dynacast into a new subsidiary pursuant to section 351 of the IRC, such transaction for federal income tax purposes would be a mere change in the form of conducting the trade or business and Petitioner would not be required to recapture the investment credit taken on the section 38 property that is transferred. Therefore, pursuant to section 1-2.1 of the Regulations, such transaction should not be considered a "disposition" as contemplated in section 210.12(g) of the Tax Law.

Section 5-2.8(e) of the Regulations provides that where property is transferred from one corporation to another corporation and there is no disposition of qualified property, an add back of investment tax credit is not required provided that the property continues in qualified use and is acquired by a corporation subject to tax under Article 9-A. Generally, in these cases, the acquiring or surviving corporation cannot claim an investment tax credit because it takes over such property at the adjusted basis of the transferor and the transfer therefore does not qualify as a purchase pursuant to Internal Revenue Code, section 179(d)(2). If the property in the hands of the acquiring corporation is not in qualified use for its entire life or for more than 12 consecutive years, a recovery from the acquiring corporation is required. In measuring the period of qualified use, the period during which the property was held by the transferor corporation and the acquiring corporation are to be taken into account.

Accordingly, Petitioner would not be required to recapture investment tax credit allowed under section 210.12(a) of the Tax Law as long as the qualifying property, in the hands of the subsidiary, continues in qualified use for its entire life or more than 12 consecutive years.

DATED: August 11, 1988

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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