

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

TSB-A-91(10)C
Corporation Tax
April 4, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C910201B

On February 1, 1991, a Petition for Advisory Opinion was received from The Homestead Savings (FA), 283 Genesee Street, Utica, New York 13501.

The issue raised by Petitioner, The Homestead Savings (FA), is what is the New York tax treatment resulting from the conversion of Petitioner from a mutual savings and loan association to a stock savings and loan association (hereinafter "Stock Homestead") and the concurrent acquisition of all the capital stock of Homestead by Iroquois Bancorp, Inc. (hereinafter "Bancorp").

Petitioner is a federally chartered mutual savings and loan association. Petitioner files a consolidated federal income tax return as the common parent of an affiliated group of corporations. The principal executive offices of Petitioner are located in Utica, New York.

As a mutual savings and loan association, Petitioner has no authorized capital stock. In the event of the liquidation of Petitioner, each savings depositor of Petitioner would have a right to share pro rata (with respect to the amount of the balance in each depositor's account as a fraction of the sum of all Petitioner's deposit accounts just prior to liquidation) in any liquidation proceeds distributed. In addition, a savings depositor in Petitioner is entitled to interest pursuant to the terms of his time account or which is declared and paid by Petitioner on his positive savings account balance. The management and control of Petitioner is vested in its Board of Directors, who have exclusive power regarding Petitioner's operations.

Bancorp is a New York corporation which engages in business as a savings and loan holding company pursuant to section 408 of the National Housing Act (hereinafter the "Act"). Bancorp files a consolidated federal income tax return as the common parent of an affiliated group of corporations. The principal office of Bancorp is located in Auburn, New York.

The Boards of Directors of Bancorp and Petitioner consider it to be in the best interests of their respective institutions, depositors, shareholders, creditors, and communities for Petitioner to convert from a mutual to stock form of organization (hereinafter "Conversion"), and become a wholly-owned subsidiary of Bancorp in its capacity as a savings and loan company (hereinafter "Acquisition"). Upon completion of the Conversion, as described below, Bancorp will acquire Stock Homestead by issuing shares of its voting common stock to persons purchasing said shares through a subscription offering and to the general public in an underwritten public offering and using the proceeds to purchase all of the capital stock of Stock Homestead.

The Conversion/Acquisition will be carried out pursuant to the terms and provisions of the Plan of Conversion and Acquisition of Homestead (hereinafter the "Plan") that has been adopted pursuant to section 563b.10(a) of the Office of Thrift Supervision (hereinafter "OTS") stock

conversion regulations and approved by the Board of Directors of Petitioner on November 12, 1990.

The corporate existence of Petitioner will not terminate as a result of the conversion to stock form but, rather, Stock Homestead, following the Conversion, will be treated as the same entity as Petitioner. Accordingly, on the effective date of the Conversion, by operation of law and without any further action, all of the assets, franchises, debts, liabilities, obligations, and duties of Petitioner will continue unchanged in Stock Homestead. Each holder of a deposit account in Petitioner immediately prior to the Conversion will become the holder of a deposit account in Stock Homestead equivalent in all respects (except as to liquidation rights) to the deposit account in Petitioner immediately prior to the time of Conversion.

In addition, for purposes of granting account holders of Petitioner a priority in the event of a complete liquidation of Petitioner after the Conversion, Stock Homestead will establish and maintain a liquidation account, for the benefit, on a pro rata basis, of all deposit account holders of Petitioner, whose deposit balances aggregate more than \$50 (hereinafter the "Qualifying Deposit") on June 30, 1990 (hereinafter "Eligibility Record Date") (hereinafter the "Eligible Account Holders"). To the extent that any subsidiary of Petitioner maintains deposit accounts in Petitioner, those accounts will not constitute Qualifying Deposits. The amount of the liquidation account shall be equal to the net worth of Petitioner as of the date of its latest statement of financial condition as set forth in the application to the OTS.

Following the Conversion of Petitioner to Stock Homestead, Stock Homestead's stock will be sold to eligible persons, and then to the general public, with the net proceeds of the sale being added to Petitioner's net worth. The Stock Homestead capital stock is then concurrently exchanged for authorized but unissued shares of common stock of Bancorp (hereinafter "Conversion Stock"). From a practical standpoint, the concurrent transactions are collapsed into one transaction with the direct offering of the Conversion Stock and all of the net conversion proceeds being retained by Petitioner following the Conversion.

The aggregate purchase price at which all shares of the Conversion: Stock will be offered and sold pursuant to the Plan will not be less than the incremental pro forma market value of Stock Homestead as a wholly-owned subsidiary of Bancorp after giving effect to the issuance of the Conversion Stock, as determined by an independent valuation. The aggregate purchase price will also be within the valuation range stated in the approval or amended approval of the Plan by the OTS.

In addition to the foregoing, the following representations are made with respect to the proposed transaction:

(a) The fair market value of each withdrawable savings account plus an interest in the liquidation account of Stock Homestead to be constructively received under the Plan will in each instance be equal to the fair market value of each withdrawable savings account of Petitioner surrendered in exchange therefor.

(b) Stock Homestead and Bancorp each have no plan or intention to redeem or otherwise acquire any of the Conversion Stock issued in the proposed transaction.

(c) Following the Conversion/Acquisition, Stock Homestead has no plan or intention to sell or otherwise dispose of any of its assets, except in the ordinary course of business, and there is no plan or intention for Stock Homestead or Bancorp to be merged with another corporation.

(d) Petitioner is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of section 368(a)(3)(A) of the Internal Revenue Code (hereinafter "IRC").

(e) No Eligible Account Holders of Petitioner as of the Eligibility Record Date under the Plan will be excluded from participating in the liquidation account.

(f) Compensation to be paid to depositor/employees of Petitioner will be commensurate with amounts paid to third parties bargaining at arm's length for similar services.

(g) The aggregate fair market value of the Qualifying Deposits held by Eligible Account Holders as of the close of business on the Eligibility Record Date equalled or exceeded 99% of the aggregate fair market value of all savings accounts (including those accounts of less than \$50) in Petitioner as of the close of business on such date.

(h) No shares of Bancorp voting common stock will be issued or purchased by depositor/employees at a discount or as compensation in the Conversion/ Acquisition.

(i) No cash or property will be received by the Eligible Account Holders of Petitioner in lieu of non-transferable subscription rights or an interest in the liquidation account of Stock Homestead.

(j) Petitioner computes its reserve for bad debts in accordance with section 593 of the IRC. Following the Conversion, Stock Homestead, will likewise utilize a reserve for bad debts in accordance with section 593 of the IRC.

(k) At the time of the Conversion/Acquisition, the fair market value of the assets of Petitioner on a going concern basis will exceed the amount of its liabilities to be assumed plus the amount of liabilities to which the transferred assets are subject.

(l) Petitioner, Stock Homestead, and Bancorp are corporations within the meaning of section 7701(a)(3) of the IRC.

(m) Bancorp is not an investment company as described in section 1.351-1(c) of the Treasury regulations.

(n) The exercise price of the subscription rights received by Petitioner's Eligible Account Holders to purchase Conversion Stock will be equal to the average of the closing prices of Bancorp common stock (as reported by NASDAQ) during the thirty days preceding the seven days prior

to the completion of the sale of Conversion Stock. If following the subscription offering and the direct community offering, however, shares of Conversion Stock are offered for sale by underwriters in a public offering, the price for each share of Conversion Stock will be the price at which unsubscribed shares are initially offered for sale in the public offering, which price will be negotiated between Bancorp and the underwriters. Pursuant to the Plan and OTS regulations, all shares of Conversion Stock shall be issued and sold at a uniform price per share.

(o) Bancorp has no plan or intention to sell or otherwise dispose of stock of Stock Homestead received by it in the proposed transaction.

(p) Petitioner's savings depositors will pay expenses of the Conversion solely attributable to them, if any. Bancorp and Petitioner will each pay its own expenses of the Conversion/Acquisition and will not pay expenses solely attributable to the savings depositors or to the Bancorp shareholders.

(q) The Eligible Account Holders proprietary interests in Petitioner arise solely by virtue of the fact that they are account holders in Petitioner.

(r) The proposed transaction does not involve a receivership, foreclosure, or similar proceeding before a federal or state agency involving a financial institution to which sections 585 or 593 of the IRC apply.

(s) The Board as defined in section 368(a)(3)(D)(iii) of the IRC has not made the certification described in section 368(a)(3)(D)(ii) of the IRC, nor will such certification be made prior to or otherwise in connection with the proposed transaction.

Contemporaneously with the submission of this Petition, Petitioner has submitted to the Internal Revenue Service an application for a private letter ruling to the effect that:

(1) The change in form of operation of Petitioner from a mutual savings and loan association to a stock savings and loan association will constitute a reorganization within the meaning of section 368(a)(1)(F) of the IRC, and no gain or loss will be recognized to Petitioner or Stock Homestead as a result of such conversion [Rev Rul 80-105, 1980-1 CB 78]. Petitioner and Stock Homestead will each be "a party to a reorganization" within the meaning of section 368(b) of the IRC.

(2) No gain or loss will be recognized by Stock Homestead on the receipt of money from Bancorp in exchange for common stock of Stock Homestead [section 1032(a) of the IRC]. No gain or loss will be recognized by Bancorp upon receipt of cash in exchange for its Conversion Stock [section 1032(a) of the IRC].

(3) No gain or loss will be recognized by Eligible Account Holders upon the issuance to them of deposit accounts in Stock Homestead in the same dollar amounts as their deposit accounts in Petitioner, plus interest in the liquidation account of Stock Petitioner, in exchange for the deposit accounts in Petitioner [section 354(a) of the IRC].

(4) The assets of Petitioner will have the same basis in the hands of Stock Homestead as in the hands of Petitioner immediately prior to the Conversion [section 362(b) of the IRC].

(5) The holding period of the assets of Petitioner to be received by Stock Homestead will include the period during which the assets were held by Petitioner prior to the Conversion [section 1223(2) of the IRC].

(6) The basis of the deposit accounts in Stock Homestead received by Eligible Account Holders will be the same as the basis of the proprietary interest surrendered in exchange therefor [section 358(a)(1) of the IRC]. Consequently the basis of each Eligible Account Holder's interest in the liquidation account will be zero [Rev Rul 71-233, 1971-1 CB 113]. The basis of the nontransferable subscription rights will be zero [sections 1.307-1 and 1.3072 of the Treasury Regulations]. The basis of the Conversion Stock acquired pursuant to the Plan will be the purchase price thereof [section 1012 of the IRC], and the holding period for such Conversion Stock will commence on the date following the date on which such stock is purchased. [Rev Rul 70-598, 1970-2 CB 168].

(7) For purposes of section 381 of the IRC, Stock Homestead will be treated as if there had been no reorganization. Accordingly, the taxable year of Petitioner will not end on the effective date of the Conversion, and the tax attributes of Petitioner will be taken into account by Stock Homestead as if there had been no reorganization [section 1.381(b)-1(a)(2) of the Treasury Regulations]. The part of the taxable year of Petitioner before the Conversion and the part of the taxable year of Stock Homestead after the Conversion will constitute a single taxable year. [Rev Rul 57-276, 1957-1 CB 126].

(8) Pursuant to section 381(c)(4) of the IRC and section 1.381(c)(4)l(a)(1)(ii) of the Treasury Regulations, Stock Homestead will succeed to and take into account, immediately after the Conversion, the dollar amounts of those accounts of Petitioner which represent bad debt reserves in respect of which Petitioner has taken a bad debt deduction for taxable years ending on or before the date of Conversion. The bad debt reserves of Petitioner will not be required to be restored to the gross income of either Petitioner or Stock Homestead as a result of the Conversion, and such bad debt reserves will have the same character in the hands of Stock Homestead as they would have had in the hands of Petitioner if the Conversion had not occurred.

(9) Regardless of the book entries made for the creation of the liquidation account, the Conversion will not diminish the accumulated earnings and profits of Stock Homestead available for the subsequent distribution of dividends, if any, within the meaning of section 316 of the IRC [section 1.312-11(b) and (c) of the Treasury Regulations].

(10) The creation of the liquidation account on the records of Stock Homestead will have no effect on its taxable income, deductions, or additions to reserves for bad debts under section 593 of the IRC or distributions to shareholders under section 593(e) of the IRC.

Section 1451 of Article 32 of the Tax Law imposes, annually, a franchise tax on every banking corporation for the privilege of exercising its franchise or doing business in New York State in a corporate or organized capacity.

Section 1455(a) of the Tax Law provides that the basic tax is nine percent of the taxpayer's entire net income, or portion thereof allocated to New York State, for the taxable year or part thereof.

Entire net income is defined in section 1453(a) of the Tax Law as "total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income) . . . which the taxpayer is required to report to the United States treasury department, . . . subject to the modifications and adjustments hereinafter provided."

Section 1453(b) through (k) of the Tax Law and sections 18-2.3, 18-2.4 and 18-2.5 of the Franchise Tax on Banking Corporations Regulations, promulgated thereunder, provide for the modifications and adjustments required by section 1453(a). However, there is no modification or adjustment applicable to a transaction where, for federal income tax purposes, the Conversion is treated as a reorganization pursuant to section 368(a)(1)(F) of the IRC and the Acquisition will result in no recognition of gain or loss under section 1032(a) of the IRC. Therefore, for purposes of section 1453 of the Tax Law, such transaction would be treated the same as it is treated for federal income tax purposes.

Accordingly, if Petitioner's change in form from a federal mutual savings and loan association to a stock savings and loan association and the concurrent acquisition of all of the capital stock of Stock Homestead by Bancorp is a tax-free reorganization and acquisition under sections 368(a)(1)(F) and 1032(a) of the IRC, respectively, such reorganization and acquisition would be tax-free for New York State franchise tax purposes under Article 32 of the Tax Law.

DATED: April 4, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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