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

TSB-A-91 (25) C
Corporation Tax
November 20, 1991

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C910820B

On August 20, 1991, a Petition for Advisory Opinion was received from Anchin, Block & Anchin, 1375 Broadway, 18th Floor, New York, New York 10018.

The issue raised by Petitioner, Anchin, Block & Anchin, is whether an unnamed client will be granted permission to file a combined report and thereby eliminate the intercorporate gain on the sale of real property and eliminate the intercorporate rental income and rental expense.

Petitioner's unnamed client (hereinafter "OLDCO") is a distributor of equipment located in New York City. It is an S corporation for federal and New York State tax purposes. If the proposed transaction is completed, OLDCO will cease to be an S corporation.

OLDCO currently owns the building in which its distribution business is conducted. For non-tax reasons related to its financing requirements, the following transaction is proposed. The sole shareholder of OLDCO will organize a new corporation (hereinafter "NEWCO") and then contribute his stock of OLDCO to NEWCO in exchange for the issuance to him of all of the outstanding shares of NEWCO in a non-taxable transaction pursuant to section 351 of the Internal Revenue Code. Therefore, immediately after the transaction, NEWCO will be a holding company with no assets other than 100 percent of the shares of OLDCO, the operating company NEWCO will then borrow money from a commercial lender and purchase the real property at fair market value from OLDCO. The commercial lender will have a security interest in the real property and in the accounts receivable of OLDCO. The sole shareholder will also guarantee the loan from the commercial lender. NEWCO will rent the property to OLDCO. The rent will approximate the financing and carrying charges of the building. The two corporations will file a consolidated federal income tax return.

Section 211.4 of the Tax Law, provides, in pertinent part, that:

> "In the discretion of the commissioner of taxation and finance, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations. . .may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the commissioner may require. . ."

Section 6-2.1 of the Business Corporation Franchise Tax Regulations (hereinafter "Regulations") provides that:

(a) Every corporation is a separate taxable entity and shall file its own report. However, the [Commissioner], in [his] discretion, may require a group of corporations to file a combined report or may grant permission to a group of corporations to file a combined report where:

(1) the requirement of stock ownership or control . . . is met;

(2) the group of corporations is engaged in a unitary business . . .and

(3) the other requirement set forth in section 6-2.3. . . of this Part . . . has been met.

(b) Each corporation in the combined report must compute and show the tax which would have been required to be shown if filed on a separate basis.

(c) The decision to permit or require a combined report will be .... base, on the facts in each case using the requirements set forth in this Part.

Section 6-2.2 of the Regulations provides:

(a) Capital stock requirement. (1) In deciding whether to permit or require a group of corporations to file a combined report, the [Commissioner] will first determine whether:

(i) the taxpayer owns or controls, either directly or indirectly, substantially all of the capital stock of all the other corporations which are to be included in the combined report; or

(ii) substantially all of the capital stock of the taxpayer is owned or controlled, either directly or indirectly, by other corporations which are to be included in the combined report; or

(iii) substantially all of the capital stock of the taxpayer and substantially all of the capital stock of the other corporations which are to be included in the combined report are owned or controlled, either directly or indirectly, by the same interests.

(2) The term substantially all means ownership or control of 80 percent or more of the voting stock. Ownership includes actual or beneficial ownership.

...(b) Unitary business requirement. (1) In deciding whether a corporation is part of a unitary business, the [Commissioner] will consider whether the activities in which the corporation engages are related to the activities of the other corporations in the group, such as:

(i) manufacturing or acquiring goods or property or performing services for other corporations in the group; or

(ii) selling goods acquired from other corporations in the group; or

(iii) financing sales of other corporations in the group.

(2) The [Commissioner], in deciding whether a corporation is part of a unitary business, will also consider whether the corporation is engaged in the same or related lines of business as the other corporations in the group, such as:

(i) manufacturing or selling similar products; or
(ii) performing similar services; or
(iii) performing services for the same customers ....

Section 6-2.3 of the Regulations provides that:

(a) If the capital stock and unitary business requirements described in section 6-2.2 of this Part have been met, the [Commissioner] may permit or require a group of taxpayers to file a combined report if reporting on a separate basis distorts the activities, business, income or capital in New York State of the taxpayers. The activities, business, income or capital of a taxpayer will be presumed to be distorted when the taxpayer reports on a separate basis if there are substantial intercorporate transactions among the corporations.

. . . .

(c) In determining whether there are substantial intercorporate transactions, the [Commissioner] will consider transactions directly connected with the business conducted by the taxpayer, such as:

(1) manufacturing or acquiring goods or property or performing services for other corporations in the group;

(2) selling goods acquired from other corporations in the group;

(3) financing sales of other corporations in the group; or

(4) performing related customer services using common facilities and employees.

Service functions will not be considered when they are incidental to the business of the corporation providing such service. Service functions include, but are not limited to, accounting, legal and personnel services. The substantial intercorporate transaction requirement may be met where as little as 50 percent of a corporation's receipts or expenses are from one or more qualified activities described in this subdivision. It is not necessary that there be substantial intercorporate transactions between any one member with every other member of the group. It is, however, essential that each

corporation have substantial intercorporate transactions with one other corporation or with a combined or combinable group of corporations.

...(d) If a taxpayer fails to meet the presumption of distortion because it does not have substantial intercorporate transactions with any corporation described in section 6-2.2 of this Part or with a combined or combinable group of such corporations and if the filing of a report on a separate basis nevertheless results in a distortion of such taxpayer's activities, business, income or capital in New York State then the [Commissioner] will permit or require the filing of a combined report. If a taxpayer meets the presumption of distortion because it has substantial intercorporate transactions with any corporation described in section 6-2.2 of this Part or with a combined or combinable group of such corporations and if the filing of a report on a separate basis does not result in a distortion of such taxpayer's activities, business, income or capital in New York State, then the [Commissioner] will not permit or require the filing of a combined report ....

Section 6-2.4(a) of the Regulations provides that:

A taxpayer must make a written request for permission to file a combined report. ...The request must be received by the [Commissioner] not later than 30 days after the close of its taxable year. . . . A request to file a combined report must include the following information:

(l) the exact name, address, employer identification number and the state of incorporation of each corporation to be included in the combined report;

(2) information showing that each of the corporations meets the requirements of sections 6-2.2 and 6-2.3 of this Part for the current year;

(3) the exact name, address, employer identification number and the state of incorporation of all corporations (except alien corporations) which meet the capital stock requirement of subdivision ia) of section 6-2.2 of this Part for the current year, which are not to be included in the combined report;

(4) for at least the first nine months of the current year submit the following information:

(i) the nature of the business conducted by each corporation included in paragraphs (1) and (3) of this subdivision;

(ii) the source and amount of gross receipts of each corporation and the portion derived from transactions with each of the other corporations;

(iii) the source and amount of total purchases, services and other transactions of each corporation and the portion related to transactions with each of the other corporations; and

(iv) any other data that shows the degree of involvement of the corporations with each other; and

(5) a statement providing details as to why a combined report which would include only the corporations listed in paragraph (1) of this subdivision will equitably reflect the New York State activities of the corporations which meet the capital stock requirement of subdivision (a) of section 6-2.2 of this Part and why the corporations in paragraph (3) of this subdivision should be excluded.

The purpose of the combined reporting provision contained in section 211.4 of the Tax Law is to avoid distortion of, and more realistically portray true income of, closely related businesses. (Matter of Coleco Inds. v State Tax Comm, 92 AD2d 1008, affd 59 NY2d 994). A combined report may not be required unless it will avoid distortion of and more realistically portray true income of closely related businesses. No single factor is decisive in properly reaching a determination that requiring combined reporting fulfills the statutory purpose (id. at 1009). Therefore, the existence of distortion must be decided based on the factual situation in each case.

Several Advisory Opinions have been issued with respect to combined reporting. In Lone Star Industries, Inc., Adv Op St Tax Comm, June 30, 1981, TSB-A-81(2)C, it was held that the granting of permission to file on a combined basis is discretionary and is dependent upon the actual facts and circumstances of each case and that permission to file a combined report may not be granted in advance. Permission may only be granted after consummation of the planned reorganization of functions and upon proper written application containing all of the information required pursuant to section 6-2.4 of the Regulations. This would include detailed information regarding activities of the corporations for the first nine months of the taxable year.

In New York Futures Exchange, Inc. and New York Futures Clearing Corporation, Adv 0p St Tax Comm, June 8, 1982, TSB-A-82(7)C and United States Surgical Corporation, Adv Op Comm T & F, January 31, 1989, TSB-A-89(2)C, it was held that eligibility for filing on a combined basis is a question of fact that can only be determined on the basis of the actual circumstances of the corporations for the taxable year.

In Schiavone-Bonomo Corporation, Adv Op St Tax Comm, September 23, 1985, TSB-A-85(17)C, it was held that the existence of distortion pursuant to section 6-2.3 of the Regulations must be decided based on the factual situation in each case and is not susceptible of determination in an Advisory Opinion.

Herein, OLDCO is contemplating a proposed transaction. Under these circumstances, the requirements of section 6-2.4 of the Regulations have not been met. Therefore, as discussed in Lone Star Industries, supra., it is not possible to determine, at this point in time,

whether a combined report including OLDCO and NEWCO will be permitted or required.

In any event, as discussed in Coleco Inds., supra., the determination of whether a combined report will be permitted or required is a factual matter and as discussed in previous Advisory Opinions issued to United States Surgical, supra, New York Futures Exchange, supra., and Schiavone-Bonomo, supra., distortion and other questions of fact are not susceptible of determination in an Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specific set of facts" Tax Law, § 171, subd. twenty-fourth; 20 NYCRR 901.1(a). Therefore, a determination cannot be made in an Advisory Opinion as to whether a combined report shall be permitted or required.

Accordingly, Petitioner's client, OLDCO and NEWCO, should follow the requirements for combined reporting as set forth in Subpart 6-2 of the Regulations and should request permission to file a combined report not later than 30 days after the close of the taxable year and supply all of the information required by section 6-2.4(a) of the Regulations.

DATED: November 20, 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.