STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C950223A

On February 23, 1995, a Petition for Advisory Opinion was received from Bruce Nadell, 156 W. 56th Street, 4th Floor, New York, New York 10019.

The issue raised by Petitioner, Bruce Nadell, is whether the corporate taxpayer, the limited liability company ("LLC") or the member owners of the LLC are entitled to claim the investment tax credit under section 210.12 of Article 9-A of the Tax Law based on a set of facts.

Petitioner submits the following facts as the basis for this Advisory Opinion.

The corporate taxpayer is a New York film production company with a March 31 taxable year end. In 1993, the corporate taxpayer started a new division devoted to video-tape post production. On October 1, 1993, the corporate taxpayer purchased, for its new division, one million dollars worth of new state-of-the-art equipment to be used in video-tape post production. The corporate taxpayer put the equipment in use in the taxable year ended March 31, 1994. The corporate taxpayer did not claim the investment tax credit in taxable year ended March 31, 1994.

On or about April 1, 1994, the corporate taxpayer spun-off its new videotape division to a newly formed LLC in a tax-free exchange under section 721 of the Internal Revenue Code ("IRC").

The LLC was formed in New Jersey, but operates exclusively in New York. The corporate taxpayer retained a 90% ownership interest in the LLC.

Section 721(a) of the IRC provides that "[n]o gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership."

Section 723 of the IRC provides, in part, that "the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution .... "

Section 210.12 of the Tax Law allows an investment tax credit against the tax imposed under Article 9-A of the Tax Law. For taxable years beginning after 1990, section 210.12 allows an investment tax credit equal to five percent with respect to the first $350 million of the investment credit base and four percent with respect to the investment credit base in excess of $350 million. The investment credit base is the cost or other basis for Federal income tax purposes of qualified tangible personal property and other tangible property, including buildings and structural components of buildings.

Section 5-2.1 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") provides that the taxpayer must claim the investment tax credit for the first taxable year in which the property becomes qualified property.

Under section 210.12(b) of the Tax Law and section 5-2.2 of the Article 9-A Regulations, the term "qualified property" means tangible personal property and other tangible property, including buildings and structural components of buildings, which:

(1) is acquired, constructed, reconstructed or erected by the taxpayer after December 31, 1968;

(2) is depreciable pursuant to section 167 of the Internal Revenue Code;

(3) has a useful life of four years or more;

(4) is acquired by the taxpayer by purchase as defined in section 179(d) of the Internal Revenue Code;

(5) has a situs in New York State; and

(6) is principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing.

Section 210.12(g) of the Tax Law and section 5-2.8(a) of the Article 9-A 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 Article 9-A Regulations provides that a disposition of qualified property <u>includes:</u>

(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 Article 9-A Regulations.

Section 1-2.1 of the Article 9-A Regulations provides that, unless a different meaning is clearly required, any term used in the Article 9-A Regulations shall presumably have the same meaning as when used in a comparable context in the IRC and the corresponding regulations. The language of section 210.12(g) of the Tax Law is parallel to that contained in section 47 of the IRC prior to the enactment of the Revenue Reconciliation Act of 1990. 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 Article 9-A Regulations, it is appropriate to apply precedent set under the IRC for Federal income tax purposes.

Section 47 of the IRC, (prior to the enactment of the Revenue Reconciliation Act of 1990 applicable to property placed in service after December 31, 1990), 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 CB 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:

(1) the section 38 property is retained as section 38 property in the same trade or business;

(2) the transferor of the section 38 property retains a substantial interest in such trade or business;

(3) substantially all the assets (whether or not section 38 property) necessary to operate the trade or business are transferred to the transferee to whom the section 38 property is transferred; and

(4) the basis of the section 38 property in the hands of the transferee is determined in whole or in part by reference to the basis of the section 38 property in the hands of the transferor.

It has been determined that where the conditions set forth in section 1.473(f)(1) of the Federal Income Tax Regulations are met, a transaction qualifying for nonrecognition treatment under section 721 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, Rev Rul 8623, 1986-1 CB 5.)

Accordingly, pursuant to section 5-2.1 of the Article 9-A Regulations, if all of the conditions set forth in section 5-2.2 of the Article 9-A Regulations have been met, a taxpayer must claim the investment tax credit for the first taxable year in which the property becomes qualified property.

In this case, if all of the conditions of section 5-2.2 of the Article 9-A Regulations are met, the corporate taxpayer must claim the investment tax credit for the qualifying property purchased on October 1, 1993, on its franchise tax report for fiscal year ended March 31, 1994. The corporate taxpayer spun-off its new video-tape division to a newly formed LLC in a tax-free exchange under section 721 of the IRC on or about April 1, 1994. For Federal income tax purposes, this transaction, pursuant to Revenue Ruling 86-23 (1986-1 CB 5), would be a mere change in the form of conducting the trade or business and the corporate taxpayer would not be required to recapture the investment credit taken on the section 38 property that was transferred.

Therefore, pursuant to section 5-2.8(c) of the Article 9-A Regulations, this transaction is not considered a "disposition" as contemplated in section 210.12(g) of the Tax Law. Where there is no disposition of qualified property, a recapture of investment tax credit is not required provided that the property continues in qualified use for its entire life or for more than 12 consecutive years.

In John J. Eaqan. Norris. McLaughlin & Marcus, Adv Op St Tax Comm, April 29, 1987, TSB-A-87(9)C, it was held that where a partnership purchases tangible personal property that is principally used by the partnership and that meets all of the requirements for qualifying for the investment tax credit, a corporate partner of the partnership is allowed an investment tax credit, pursuant to section 210.12(a) of the Tax Law, for its allocable share of the cost or other basis of such qualifying tangible personal property.

Section 2 of the Tax Law provides the definition of certain terms used in the Tax Law, and was amended by Chapter 576 of the Laws of 1994 which added the following:

> 5. The term "limited liability company" means a domestic limited liability company or a foreign limited liability company, as defined in section one hundred two of the limited liability company law.
>
> 6. "Partnership and partner," unless the context requires otherwise, shall include, but shall not be limited to, a limited liability company and a member thereof, respectively.

Section 208.1 of the Tax Law provides that the term "corporation" includes an association within the meaning of section 7701(a)(3) of the IRC, including an LLC.

Accordingly, an LLC that is treated as a corporation for Federal income tax purposes is treated as a corporation for New York State tax purposes. An LLC that is treated as a partnership for Federal income tax purposes, is treated as a partnership for New York State tax purposes. (See, Department of Taxation and Finance Memorandum, TSB-M-94(6)I and (8)C, October 25, 1994.)

Since an LLC that is treated as a partnership for Federal income tax purposes is treated as a partnership for New York State tax purposes, it is consistent to treat a corporate member of an LLC like a corporate partner of a partnership. That is, where a corporate partner of a partnership is allowed to claim an investment tax credit on qualifying property that is principally used by the partnership, a corporate member of an LLC is allowed to claim an investment tax credit on qualifying property that is principally used by the LLC. Further, as long as the tangible personal property continues to be in qualified use by the LLC, the property continues to be in qualified use by a corporate member of the LLC.

In this case, when the corporate taxpayer spun-off its new video-tape division to a newly formed LLC in a tax-free exchange under section 721 of the IRC and the property continues in qualified use by the LLC, the property continues to be in qualified use by the corporate taxpayer pursuant to section 1-2.1 of the Article 9-A Regulations. Therefore, a recapture of the investment tax credit claimed by the corporate taxpayer in the first year the equipment was in qualified use, that is, for taxable year ended March 31, 1994, is not required by section 210.12(g) of the Tax Law and section 5-2.8(a) of the Article 9-A Regulations.

It should be noted that, since the LLC in this case is treated as a partnership and is not a taxpayer, the LLC is not entitled to claim an investment tax credit. Further, the members of the LLC cannot claim an investment tax credit on the qualifying property purchased by the corporate taxpayer on October 1, 1993 and spun-off to the LLC. The reason is that, pursuant to section 723 of the IRC, the LLC takes over the qualifying property at the adjusted basis of the transferor, and, therefore, the transfer does not qualify as a purchase pursuant to section 179(d) of the IRC as required in section 210.12(b) of the Tax Law and section 5-2.2 of the Article 9-A Regulations.

/s/

DATED: May 2, 1996

DORIS S. BAUMAN
Director
Technical Services Bureau

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