STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C961231A

On December 31, 1996, a Petition for Advisory Opinion was received from Enviro-Gro Technologies, Inc., Tax Department, 3000 Butterfield Road, Oak Brook, Illinois 60521.

The issue raised by Petitioner, Enviro-Gro Technologies, Inc., is whether recapture of the investment tax credit claimed under section 210.12 of the Tax Law is required by reason of the proposed restructuring brought about by the tax-free mergers of the corporate partners of a partnership owning qualified property.

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

NYOFCO

Petitioner, a Delaware corporation ("EGT"), owns a 51 percent partnership interest in New York Organic Fertilizer Company, a New York general partnership ("NYOFCO"). The other 49 percent of NYOFCO is owned by Enviro-Gro Technologies II, Inc., a Delaware corporation ("EGT II"). EGT and EGT II are wholly-owned subsidiaries of Wheelabrator Water Technologies, Inc., a Maryland corporation ("WWTI"), subject to taxation in New York under Article 9-A of the Tax Law.

In 1993, NYOFCO purchased and placed in service certain property that was eligible for investment tax credit under section 210.12 of the Tax Law. EGT and EGT II claimed 51 percent and 49 percent of the credit, respectively, based on their proportionate interests in NYOFCO. Most of the property for which the investment tax credit was claimed is seven-year property being depreciated pursuant to section 168 of the Internal Revenue Code ("IRC") over a seven-year period.

Proposed Restructuring

EGT and EGT II are contemplating a restructuring which will consist of the following steps:

1. EGT will form a new wholly-owned subsidiary ("Newco").

2. EGT will transfer a one percent interest in NYOFCO to Newco.

3. EGT and EGT II will merge into their parent, WWTI. Pursuant to this merger, all assets owned by EGT and EGT II (the NYOFCO interests and Newco stock) will be transferred to WWTI.

At the conclusion of the restructuring, WWTI will own 99 percent of NYOFCO, and it will own 100 percent of the stock of Newco, which will own the remaining one percent of NYOFCO.

At all times, NYOFCO will have at least two partners, and for purposes of the New York State Partnership Law it will continue as a partnership. The property for which the investment tax credit was claimed will not be transferred. The property will continue in qualified use and will remain in NYOFCO's hands both before and after the contemplated restructuring. Partnership interests in NYOFCO will be transferred when Newco is formed and when EGT and EGT II merge into WWTI.

Petitioner states that this restructuring will be tax-free for federal income tax and New York State franchise tax purposes. The formation of Newco and transfer to it of the one percent NYOFCO interest will be tax-free under section 351 of the IRC, and the mergers of EGT and EGT II into WWTI will be tax-free transactions described in sections 332 and 368(a)(1)(A) of the IRC.

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 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.

Section 5-2.8(e) of the Article 9-A Regulations provides that

> [f]or purposes of this section, a disposition does not occur where property is transferred from a corporation as part of a transaction to which section 381(a) of the Internal Revenue Code applies; *e.g.*, a complete liquidation of a subsidiary under section 332 of the Internal Revenue Code, or a reorganization under ... section 368(a)(1)(A) (statutory merger or consolidation) ... As there is no disposition in these cases, an add back 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.

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. However, it has been held that a tax-free transfer pursuant to section 351 of the IRC, that for federal income tax purposes would not require the recapture of the investment tax credit taken on section 38 of the IRC property, does not constitute a "disposition" as contemplated in section 210.12(g) of the Tax Law. See Coats & Clark Inc., Adv Op Comm T & F, August 11, 1988, TSB-A-88(16)C; Milton Roy Company, Adv Op Comm T F, February 10, 1993, TSB-A-93(7)C; and Morrison & Foerster LLP, Adv Op Comm T & F, December 19, 1996, TSB-A-96(27)C.

In John J. Eagan, 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, the property is deemed to be purchased by each partner to the extent of the partner's allocable or pro rata share of the partnership's property. Therefore, where the property 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.

In this case, NYOFCO purchased and placed in service property that was eligible for investment tax credit under section 210.12 of the Tax Law. Pursuant to John Eagan, supra, EGT and EGT II, as corporate partners, were deemed to have purchased the property. The property met all of the requirements for qualifying for the investment tax credit, and EGT and EGT II were each allowed an investment tax credit, pursuant to section 210.12 of the Tax Law, for their allocable share of the cost or other basis of the qualifying property. Since EGT and EGT II have claimed the investment tax credit, it must be determined whether a disposition of the qualifying property was made by EGT and EGT II.

Petitioner states that the formation of Newco by EGT and the transfer to Newco by EGT of the one percent NYOFCO interest will be tax-free under section 351 of the IRC. Accordingly, pursuant to section 5-2.8 of the Article 9-A Regulations and Coats & Clark, supra, Milton Roy, supra, and Morrison Foerster, supra, it appears that this transaction is not considered a "disposition" by EGT as contemplated in section 210.12(g) of the Tax Law.

Petitioner also states that the mergers of EGT and EGT II will be tax-free reorganizations described in sections 332 and 368(a)(1)(A) of the IRC. Pursuant to section 5-2.8(c)(2) and (e) of the Article 9-A of the Regulations, a "disposition", as contemplated in section 210.12(g) of the Tax Law, does not occur as a result of a complete liquidation of a subsidiary under section 332 of the IRC or a reorganization that constitutes a statutory merger or consolidation under section 368(a)(1)(A) of the IRC. Accordingly, it appears that EGT and EGT II will not dispose of the qualifying property when they are merged into their parent, WWTI, under reorganizations that qualify as tax-free reorganizations described in sections 332 and 368(a)(1)(A) of the IRC.

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. Therefore, it appears that the restructuring proposed in the facts of this case will not require the recapture of a portion of the investment tax credit claimed by EGT and EGT II.

/s/

DATED: March 28, 1997

John W. Bartlett
Deputy Director
Technical Services Bureau

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