

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

TSB-A-98(6)C  
Corporation Tax

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C980324A

On March 24, 1998, a Petition for Advisory Opinion was received from Consolidated Edison Company of New York, Inc., 4 Irving Place, Room 1875-S, New York, New York 10003.

The issue raised by Petitioner, Consolidated Edison Company of New York, Inc., is whether Petitioner's purchase of the stock of its parent from a third party results in a constructive dividend distribution from Petitioner to its parent, and if so, whether such constructive dividend distribution by Petitioner is subject to the excess dividends tax pursuant to section 186 of the Tax Law.

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

Petitioner, a wholly-owned subsidiary of Consolidated Edison, Inc. ("CEI"), is a regulated public utility incorporated in New York State on November 10, 1884. Petitioner supplies electricity and electric services in all of New York City (except a part of the Borough of Queens) and most of Westchester County. It also supplies gas and gas services in Manhattan, the Bronx and parts of Queens and Westchester County, as well as steam and steam services in Manhattan. Petitioner is subject to tax under Article 9 of the Tax Law. CEI is a publicly traded holding company and is subject to tax under Article 9-A of the Tax Law. The principal offices of both Petitioner and CEI are located at 4 Irving Place, New York, New York.

CEI and Petitioner have authorized the repurchase of up to \$1 billion of CEI common stock, subject to receiving New York State Public Service Commission ("PSC") approval and market conditions. To effectuate this stock repurchase, it is proposed that Petitioner directly purchase the publicly traded common stock of CEI, its parent corporation, on the open market in a transaction known as a related party redemption. After purchasing such stock, Petitioner will continue to hold the CEI common stock. There will be no pro rata distribution of property to shareholders or a class of shareholders. Petitioner will simply purchase the stock of CEI from those shareholders of CEI who wish to sell their stock.

Petitioner states that for federal income tax purposes, Petitioner's purchase of the CEI common stock held by CEI's public shareholders would be treated as a direct redemption by CEI for purposes of determining the tax consequences to such public shareholders. Section 304(a)(2) of the Internal Revenue Code provides that if (1) a corporation (referred to as the "subsidiary" or "acquiring" corporation) acquires the stock of another corporation (referred to as the "parent" or "issuing" corporation) from a stockholder of the parent corporation in return for "property", and (2) the parent corporation "controls" the acquiring corporation, then the property paid for the parent stock shall be treated as a distribution in redemption of the stock of the parent corporation.

Petitioner also states that the Internal Revenue Service, in Revenue Ruling 80-189, 1980-2 CB 106, specifically ruled that the purchase of the stock of a parent corporation (Parent) from a shareholder of the Parent by a subsidiary of the Parent will not result in a constructive distribution to the Parent from the subsidiary for federal income tax purposes. The Parent's adjusted basis in the subsidiary's stock will remain the same as it was prior to the transaction, and the subsidiary, under section 1012 of the Internal Revenue Code, will have a basis in the Parent's stock acquired in the transaction equal to the amount paid therefor.

### Discussion

Unlike Article 9-A of the Tax Law which uses federal taxable income as the starting point for computing entire net income, section 186 of the Tax Law is not federally conformed. The determination of what constitutes "gross earnings" and "dividends" for purposes of section 186 is made using the definitions contained in the section, including the case history in these areas, and applying generally accepted accounting principles.

Section 186 of the Tax Law imposes a franchise tax upon every corporation, joint-stock company or association formed for or principally engaged in the business of supplying gas, when delivered through mains or pipes, or electricity, "for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state". The tax is three-quarters of one percent on the taxpayer's gross earnings from all sources within New York State, and four and one-half percent on the amount of dividends paid during each year ending on the thirty-first day of December in excess of four percent on the actual amount of paid-in capital employed in New York State by the taxpayer.

In People ex rel Adams Electric Light Co v Graves, 272 NY 77,79, the Court of Appeals stated that under the franchise tax imposed by section 186 of the Tax Law "[a] dividend on corporate stock implies a division or distribution of corporate profits." In that case, the Court held that the transfer of a portion of earned surplus to its non-par capital stock account, pursuant to a resolution of its board of directors, was not a distribution of dividends for tax purposes. Neither money nor property nor stock dividend went into the hands of stockholders. No stockholder acquired a right to receive any equivalent of the amount transferred unless further corporate action was taken.

In this case, Petitioner will directly purchase publicly traded common stock of CEI, its parent corporation, on the open market in a transaction known as a related party redemption. After purchasing such stock, Petitioner will continue to hold the CEI common stock. There will be no distribution of property

to shareholders or a class of shareholders. Accordingly, Petitioner's related party redemption and the holding of the common stock will be treated as a distribution in redemption of the stock of CEI, and does not constitute a constructive dividend distribution from Petitioner to its parent for purposes of computing the excess dividends tax under section 186 of the Tax Law.

DATED: May 29, 1998

/s/  
John W. Bartlett  
Deputy Director  
Technical Services Bureau

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