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

TSB-A-99(22)C
Corporation Tax
September 14, 1999

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C990727B

On July 27, 1999, a Petition for Advisory Opinion was received from Roger Cukras, Hutton Ingram Yuzek Gainen Carroll & Bertolotti, LLP, 250 Park Avenue, New York, New York 10177.

The issue raised by Petitioner, Roger Cukras, is whether the tax treatment accorded to elections under section 338(h)(10) of the Internal Revenue Code ("IRC") as specified in TSB-M-91(4)C, applies to the sale of stock of a subsidiary which is an Article 9 corporation. If not, what tax treatment would be accorded to the sale of the stock of such a subsidiary, and the deemed sale of the subsidiary's assets.

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

Assume that P, the parent of a federal consolidated group, is selling to X all of the stock of T, P's wholly-owned subsidiary. Assume further that P is taxable under Article 9-A of the Tax Law, and that T is taxable under Article 9 of the Tax Law. Also assume that an election will be properly made under section 338(h)(10) of the IRC with respect to the sale of T.

Discussion

Under section 338(a) of the IRC an election may be made by the purchaser in a qualified stock purchase, which generally is one involving the purchase of 80 percent or more of the stock of a corporation within a 12 month period. Pursuant to this election, the target corporation (old target) is "treated as having sold all of its assets at the close of the acquisition date" (the date of the qualified stock purchase) "at fair market value in a single transaction" and is then "treated as a new corporation" (new target) "which purchased all of the assets ... as of the beginning of the day after the acquisition date." The result of the election is that the difference between the fair market value of the assets and the adjusted basis of the assets is recognized as gain or loss to old target, and the basis of the assets in the hands of new target is stepped up or down, as the case may be.

If the election is made under section 338(a) of the IRC, a further election may be made under section 338(h)(10) of the IRC, and section 1.338(h)(10)-1 of the Treasury Regulations, by the seller and purchaser of target stock. Under this election, target generally is deemed to sell all of its assets and distribute the proceeds in complete liquidation, and the sale of target stock included in the qualified stock purchase generally is ignored. This election may be made for target only if it is a member of a selling consolidated group, a member of a selling affiliated group filing separate returns, or an S corporation. The gain or loss on the deemed asset sale is included in the tax return

of target, but no gain or loss is recognized on the sale of target stock by members of the consolidated group, the selling affiliate or the S corporation shareholders.

Technical Services Bureau Memorandum TSB-M-91(4)C, April 17, 1991, revised the New York treatment of elections made under section 338(h)(10) of the IRC set forth in Technical Services Bureau Memorandum TSB-M-87(4)C, April 10, 1987 by making technical corrections to the treatment of the elections and simplifying the filing requirements. In both memoranda, the treatment of the elections made under section 338(h)(10) of the IRC is for purposes of Article 9-A of the Tax Law.

The starting point for computing the parent's entire net income base under Article 9-A of the Tax Law is its federal taxable income computed as if it had filed separately for federal income tax purposes (pro forma federal return). Pursuant to TSB-M-91(4)C, if the parent had filed separately for federal purposes, the election under section 338(h)(10) of the IRC would not be available, and, therefore, any gain or loss from the parent's sale of the stock of the target corporation would be included in its pro forma federal return, and in the starting point for computing the parent's entire net income under section 208.9 of Article 9-A of the Tax Law. However, such gain or loss would be attributable to subsidiary capital, and pursuant to section 208.9 of the Tax Law, income, gains and losses from subsidiary capital are excluded from entire net income.

However, subsequent to the issuance of TSB-M-91(4)C, section 1.338(h)(10)-1 of the Treasury Regulations, relating to the stock and asset consistency rules under section 338 of the IRC was adopted on January 12, 1994. This final regulation extended section 338(h)(10) of the IRC treatment to nonconsolidated affiliates. Section 1.338(h)(10)-1(c)(4) of the Treasury Regulations defines a "selling affiliate" as a domestic corporation that is not a member of the selling consolidated group and from which, on the acquisition date, the purchasing corporation purchases an amount of target stock that satisfies the requirements of section 1504(a)(2) of the IRC. Thus, on the acquisition date, the selling affiliate and the target corporation are affiliated (within the meaning of section 1504 of the IRC) but are not includible members of a consolidated group.

In this case, P, a corporation taxable under Article 9-A of the Tax Law, would file on a separate basis, and P's starting point for computing entire net income would be P's federal taxable income computed on a pro forma basis as if P had filed a separate return for federal income tax purposes. Assuming P would be a selling affiliate pursuant to section 1.338(h)(10)-1(c)(4) of the Treasury Regulations, the election made under section 338(h)(10) of the IRC to exclude the gain or loss on the sale of the target's stock would be available on P's pro forma federal return. Therefore, when P sells T's stock, any gain or loss on the sale of the stock would not be recognized on P's pro forma federal return, or in the starting point for computing P's entire net income pursuant to section 208.9 of the Tax Law. There is no modification under section 208.9 of the Tax Law that would require P to recognize any gain or loss on the sale of T's stock.

However, if P would not be a selling affiliate pursuant to section 1.338(h)(10)(c)(4) of the Treasury Regulations, then the provisions of TSB-M-91(4)C would apply. In that case, on P's pro forma federal return, the election made under section 338(h)(10) of the IRC to exclude the gain or loss on the sale of T's stock would not be available. The gain or loss on the sale of T's stock would be recognized on P's pro forma federal return and in the starting point for computing P's entire net income, but would be attributable to subsidiary capital and eliminated from P's entire net income pursuant to section 208.9(a)(1) of the Tax Law.

Unlike Article 9-A of the Tax Law, which uses federal taxable income as the starting point for computing entire net income, the provisions of Article 9 are not federally conformed. Under Article 9 of the Tax Law, the definitions contained in the pertinent sections of Article 9 and generally accepted accounting principles are applied.

In this case, with respect to T, a corporation that is taxable under Article 9 of the Tax Law, the federal tax treatment of an election made under section 338(h)(10) of the IRC, whereby any amount of gain or loss recognized upon a deemed sale of assets by the target corporation is recognized by the target corporation, is not applicable when determining the franchise tax liability of T. Any imputed gain attributable to the deemed sale of T's assets under the section 338(a) of the IRC election would not be recognized under Article 9 of the Tax Law.

DATED: September 14, 1999

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

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