New York State Department of Taxation and Finance
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Corporation Tax
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Income Tax
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1989 Legislation
Mergers and Acquisitions

General Information

Chapter 61 of the Laws of 1989 amended Tax Law Articles 9-A and 22 in part to limit tax benefits associated with certain business restructuring. The new provisions are effective for tax years beginning on or after January l, 1989, but apply only to transactions completed on or after April 19, 1989. Certain transactions are statutorily excluded:

- stock redemptions to the extent qualified under Internal Revenue Code Section 303 (redemptions generally intended to pay estate taxes and certain administrative expenses);

- acquisitions, mergers and consolidations between members of an affiliated group as defined herein; and

- acquisitions by an entity controlled by a majority of the employees of the target corporation or a trust for the exclusive benefit of such employees.

The new provisions provide that, unless the transaction is specifically excluded:

- In the case of any merger, consolidation or acquisition, the tax benefits of the target corporation's unused investment tax credit, unused employment incentive credit (additional investment tax credit) and unused research and development tax credit are lost;

- In the case of a highly leveraged transaction, up to 5% of the total interest expense of the acquiring corporation or affiliated group may be a required add back in the computation of New York taxable income. In addition, the target must recapture a portion of the investment tax credit, employment incentive tax credit and research and development credit taken by it in tax years prior to the acquisition year. Also, both the target corporation and the acquiring corporation lose the benefit of the target corporation's unused net

operating loss carryforward; and

- In any acquisition, whether or not highly leveraged, if a sufficient portion of the target's stock and/or assets is sold or otherwise disposed of within 18 months after the acquisition date, subsidiary capital treatment of the target by the acquirer is denied.

Definition of Terms

A. General Definitions

"Corporate merger" means a procedure under Article 9 of the business corporation law, the corresponding statutes of other states and/or the corresponding statutes of foreign nations comprised of the merging of two or more constituent corporations into a single corporation which is one of the constituent corporations. In the case of a corporate merger, "acquiring person" means the constituent corporation the stockholders of which, after the merger, own the largest proportion of the total voting power in the surviving corporation, and "target corporation" means all other constituent corporations. A corporate merger does not include an excluded transaction as defined below or a procedure described herein that was completed prior to April 19, 1989.

"Corporate consolidation" means a procedure, under Article 9 of the business corporation law, the corresponding statutes of other states and/or the corresponding statutes of foreign nations, comprised of the consolidation of two or more corporations into a single corporation which is a new corporation to be formed pursuant to the consolidation. In the case of a corporate consolidation, "acquiring person" means the constituent corporation the stockholders of which after the consolidation, own the largest proportion of the total voting power in the consolidated corporation, and "target corporation" means all other constituent corporations. A corporate consolidation does not include an excluded transaction as defined below or a procedure described herein which was completed prior to April 19, 1989.

"Corporate acquisition" means the acquisition on an "acquisition date" by purchase and/or otherwise (including redemption), by a person (the "acquiring person"), as the term person is defined in Section 7701(a)(1) of the Internal Revenue Code, of stock of a corporation (the "target corporation"), such that immediately prior to such acquisition such person owned 50% or less, and immediately thereafter owned more than 50% of the total voting power in the target corporation.

A corporate acquisition does not include an excluded transaction as defined below or an acquisition described herein which occurred prior to April 19, 1989.

"Excluded transaction" means: (a) an acquisition

(i) which occurs solely by reason of a redemption of stock to the extent that such redemption qualifies under Section 303 of the Internal Revenue Code;

(ii) where a corporation and the corporation acquiring it are members of an affiliated group, as defined in Section 1504 of the Internal Revenue Code, except that the term "common parent corporation" shall be deemed to mean any person, as defined in Section 7701(a)(1) of the Internal Revenue Code, and except that references to "at least 80 percent" in such Section 1504 shall be read as "more than 50 percent"; or

(iii) by a person, as defined in Section 7701 (a)(1) of the Internal Revenue Code, which is controlled by a majority of the employees of the target corporation or which is a trust for the exclusive benefit of such employees or their beneficiaries. Control in this context refers (1) in the case of a corporation, to ownership of more than 50% of the total voting power in such corporation, and (2) in the case of a partnership, where the sum of the employees' interests in the partnership, within the meaning of Section 704(b) of the Internal Revenue Code, exceeds 50%;

(b) A merger or consolidation where all the constituent corporations are members of an affiliated group, as defined in Section 1504 of the Internal Revenue Code, except that the term "common parent corporation" shall be deemed to mean any person, as defined in Section 7701 (a)(1) of the Internal Revenue Code, and except that reference to "at least 80%" in such Section 1504 shall be read as "more than 50%."

B. Subdivision 17 Definitions

"Subdivision 17 or highly leveraged corporate acquisition" means a corporate acquisition wherein the taxpayer is the target corporation and:

1) where the ratio of average aggregate debt to average aggregate equity, for the taxable year in which such acquisition occurred, increases by more than l00% over such ratio for the immediately preceding taxable year, and

2) where the ratio of average aggregate debt to average aggregate assets, for the taxable year in which such acquisition occurred, increases by more than 60% over such ratio for the immediately preceding taxable year, and

3) where the total of the acquiring person's interest paid or accrued during its taxable year in which such acquisition occurred is more than $1,000,000.

For purposes of a subdivision 17 corporate acquisition, "Average aggregate debt" for a given taxable year means the sum of (i) the average debt of the acquiring person plus (ii) the average debt of the taxpayer (unless the taxpayer is a member of an affiliated group which includes the acquiring person). In computing average aggregate debt, intercompany debt shall be eliminated.

"Average aggregate equity" for a given taxable year means the sum of (i) the average equity of the acquiring person plus (ii) the average equity of the taxpayer (unless the taxpayer is a member of an affiliated group which includes the acquiring person). In computing average aggregate equity, intercompany equity shall be eliminated.

"Average aggregate assets" for a given taxable year means the sum of (i) the average assets of the acquiring person plus (ii) the average assets of the taxpayer (unless the taxpayer is a member of an affiliated group which includes the acquiring person). In computing average aggregate assets, intercompany assets shall be eliminated.

"Value of assets" means the value shown on the books and records of a corporation using the method of accounting regularly used by that corporation.

The term "affiliated group" means an affiliated group as defined in Section 1504 of the Internal Revenue Code except that:

(i) References to "at least 80%" in such Section 1504 shall be read as "more than 50%".

(ii) Such Section 1504 shall be read without regard to the exclusion of foreign corporations provided for in Section 1504 (b)(3) (provided that the debt, equity and assets of such foreign corporations shall be included only to the extent that they are effectively connected with the conduct of a trade or business within the United States).

(iii) Such Section 1504 shall be read without regard to the exclusion provided for in Section 1504(b)(4).

C. Subdivision 18 Definitions

"Subdivision 18 corporate merger or corporate consolidation" is a corporate merger or corporate consolidation wherein the taxpayer is the surviving or consolidated corporation and:

(1) where the ratio of average aggregate debt to average aggregate equity, for the taxable year in which such merger or consolidation occurred, increases by more than 100% over such ratio for the immediately preceding taxable year, and

(2) where the ratio of average aggregate debt to average aggregate assets, for the taxable year in which such merger or consolidation occurred, increases by more than 60% over such ratio for the immediately preceding taxable year, and

(3) where the total interest paid or accrued by the surviving or consolidated corporation during its taxable year in which such merger or consolidation occurred is more than $1,000,000.

For purposes of a subdivision 18 corporate merger or corporate consolidation "Average aggregate debt" for a given taxable year means the sum of (i) the average debt of the surviving or consolidated corporation plus (ii) the average debt of the constituents. In computing average aggregate debt, intercompany debt shall be eliminated.

"Average aggregate equity" for a given taxable year means the sum of (i) the average equity of the surviving or consolidated corporation plus (ii) the average equity of the constituents. In computing average aggregate equity, intercompany equity shall be eliminated.

"Average aggregate assets" for a given taxable year means the sum of (i) the average assets of the surviving or consolidated corporation plus (ii) the average assets of the constituents. In computing average aggregate assets, intercompany assets shall be eliminated.

"Value of assets" means the value shown on the books and records of a corporation using the method of accounting regularly used by that corporation.

Interest Addback

An addback of interest expense paid or accrued is required if, during the taxable year or within the three immediately preceding taxable years, the taxpayer:

1. was an acquiring person in a corporate acquisition and the cost of the taxpayer's total interest (at any time during the year in which such acquisition occurs) in the acquired corporation exceeded $5,000,000;

2. has acquired (i) substantially all of the assets of another corporation (other than assets disposed of in the usual or regular course of business actually conducted by such corporation) pursuant to a vote by the shareholders of such corporation pursuant to section 909 of the New York State Business Corporation Law or a similar law of another state or country,

   . (ii) in the absence of such a statutory requirement, an asset of another corporation such that immediately prior to the acquisition date the taxpayer owned less than 80% of the assets of such other corporation (as of the date 18 months prior to such acquisition date) and immediately thereafter owned 80% or more of such assets, but

   . (iii) only where the cost of the assets so acquired is in excess of $5,000,000 and only where the acquisition occurred on or after April 19, 1989;

3. was a surviving corporation with respect to a corporate merger or a consolidated corporation with respect to a corporate consolidation, where the total business, investment and subsidiary capital (computed pursuant to subdivision 2 of section 210 whether or not subject to Article 9-A) of any target corporation immediately prior to such merger or consolidation exceeded $5,000,000; or

4. is a member of an affiliated group which includes a corporation described in 1,2 or 3 above.

The addback is not required if the taxpayer can demonstrate that:

1. the ratio of average aggregate debt to average aggregate equity for the taxable year in which the taxable event takes place does not increase by more than 100% over the same ratio for the immediately preceding taxable year; or

2. the ratio of average aggregate debt to average aggregate assets for the taxable year in which the taxable event takes place does not increase by more than 60% over the same ratio for the immediately preceding taxable year; or

3. the taxpayer is <u>not</u> a member of an affiliated group, the total interest expense paid or accrued during the tax year is less than $1,000,000, or

4. the taxpayer <u>is</u> a member of an affiliated group and the total interest expense paid or accrued during the tax year of the group is less than $1,000,000.

The amount of the addback is 5% of interest paid or accrued during the tax year subject to a limitation amount. The limitation amount is computed as follows:

$$\text{Total interest deducted in computing entire net income before the addback} \times \frac{\text{Cost, value of assets acquired or total business, investment and subsidairy capital of target corporations acquired this year or three immediately preceding taxable years}}{\text{Average Total Debt for the taxable year}}$$

Income From Subsidiary Capital

In any acquisition, highly leveraged or otherwise, the acquirer is required to hold more than 50% of target's stock for at least 18 months after the acquisition date, in order to retain subsidiary capital treatment for interest, dividends and gains received from the target. Additionally, the target cannot sell or otherwise dispose of more than 50% in value of its assets held on the date of acquisition (exclusive of cash and assets disposed of in the regular course of target's business) within 18 months of the acquisition date.

If a sufficient portion of the target's stock and/or assets is sold or otherwise disposed of within 18 months following the acquisition date, subsidiary capital treatment of the target by the acquirer is denied in the year of sale. The parent is required to include in the computation of its entire net income, interest and dividends received from the target corporation and gains from such stock sales. In addition, entire net income must be increased by the amount of dividends excluded in the year prior to the disposition. In both situations, a 50% dividend deduction is not allowed. For asset dispositions, loss of subsidiary capital treatment continues to 18 months following the disposition. Stock sales result in such treatment as long as the stock owned is 50% or less.

Net Operating Loss Deduction

For taxable years beginning on or after 1/1/89, the New York State net operating loss carryback and carryforward of corporations involved in a subdivision 17 corporate acquisition or a subdivision 18 corporate merger or consolidation recorded on or after 4/19/89 will be computed as follows:

Highly Leveraged Corporate Acquisition

	Target Corporations Taxable Years	Acquiring Corporations Taxable Years
Prior Year	1/1/87-12/31/87	7/1/86-6/30/87
Prior Year	1/1/88-12/31/88	7/1/87-6/30/88
Acquisition Year	1/1/89-12/31/89(acquired on 6/30/89)	7/1/88-6/30/89
Subsequent Year	1/1/90-12/31/90	7/1/89-6/30/90

Generally, any New York State loss sustained by the target corporation for 1/1/87-12/31/87 can be carried back or carried forward to 1/1/88-12/31/88, but cannot be carried to 1/1/88-12/31/88 or subsequent taxable years.

Generally, any New York State loss sustained by the target corporation for 1/1/88-12/31/88 can be carried back, but cannot be carried forward, to 1/1/89-12/31/89 or subsequent taxable years.

Any New York State loss sustained by the target corporation for 1/1/89-12/31/89 can be carried back (limited to $10,000 for loss years ending after 6/30/89), but cannot be carried forward.

Any New York State loss sustained by the target corporation for 1/1/90-12/31/90 can be carried back (limited to $10,000 for loss years ending after 6/30/89) or carried forward by the target corporation.

Any New York State loss sustained by the target corporation for 1/1/87-12/31/87, 1/1/88-12/31/88, 1/1/89-12/31/89 or 1/1/90-12/31/90 cannot be used by the acquiring corporation.

Any New York State loss sustained by the acquiring corporation for 7/1/86-6/30/87, 7/1/87-6/30/88, 7/1/88-6/30/89 or 7/1/89-6/30/90 can be carried back (limited to $10,000 for loss years ending after 6/30/89) or carried forward by the acquiring corporation.

Subdivision 18 Corporate Merger

	Target Corporations Taxable Years	Acquiring Corporations Taxable Years
Prior Years	1/1/88-12/31/88	7/1/87-6/30/88
Merger Years	1/1/89- 6/30/89(merged on 6/30/89)	7/1/88-6/30/89
Subsequent Year	NONE	7/1/89-6/30/90

Any New York State loss sustained by the target corporation for 1/1/88-12/31/88 can be carried back or carried forward to 1/1/89-6/30/89.

Any New York State loss sustained by the target corporation for 1/1/89-6/30/89 can be carried back.

Any New York State loss sustained by the target corporation for 1/1/89-12/31/88 or 1/1/89-6/30/89 cannot be used by the acquiring corporation.

Any New York State loss sustained by the acquiring corporation for 7/1/87-6/30/88, 7/1/88-6/30/89 or 7/1/89-6/30/90 can be carried back (limited to $10,000 for loss years ending after 6/30/89) or carried forward by the acquiring corporation.

Subdivision 18 Corporate Consolidation

	Target Corporations Taxable Years	Acquiring Corporations Taxable Years
Prior Years	1/1/88-12/31/88	7/1/87-6/30/88
Consolidation Year	1/1/89-6/30/89(Consolidated on 6/30/89)	Consolidated Corporation's Taxable Years 7/1/88-6/30/89
Subsequent Year	NONE	7/1/89-6/30/90

Any New York State loss sustained by the target corporation for 1/1/88-12/31/88 can be carried back or carried forward to 1/1/89- 6/30/89.

Any New York State loss sustained by the target corporation for 1/1/89-6/30/89 can be carried back.

Any New York State loss sustained by the target corporation for 1/1/88-12/31/88 or 1/1/89-6/30/89 cannot be used by the acquiring corporation.

Article 22-Personal Income Tax

Chapter 61 of the Laws of 1989 made three amendments to Article 22 of the Tax Law concerning corporate acquisitions, as this term is defined in subdivision 15 of section 208 of the Tax Law. Mergers and consolidations have no tax consequences for personal income tax purposes. These amendments, explained below, have the same effective date as the corporation tax provisions.

New section 612(t) defines certain terms relating to stock and asset acquisitions. Terms and requirements relating to acquisitions, previously discussed in the corporate tax section of this memorandum, are applicable for personal income tax purposes. However, terms specific to the personal income tax are defined below:

"Acquiring person" is an individual, a partnership of which the taxpayer is a partner, a New York electing S Corporation of which the taxpayer is a shareholder or an estate or trust of which the taxpayer is a beneficiary,

"Acquisition-related interest" means:

(i) for individual taxpayers, interest paid or accrued by the taxpayer other than personal interest and qualified residence interest.

(ii) for taxpayers associated with partnerships, S corporations or estates or trusts, the taxpayer's distributive or pro-rata share of interest paid or accrued by such entity.

"Average aggregate debt" for a given taxable year means the sum of (i) the average debt of the taxpayer plus (ii) the average debt of the target corporation. In computing this amount, intercompany debt is eliminated.

"Average aggregate equity" for a given taxable year means the sum of (i) the average equity of the taxpayer plus (ii) the average equity of the target corporation. In computing this amount, intercompany equity is eliminated.

"Average aggregate assets" for a given taxable year means the sum of (i) the average assets of the taxpayer plus (ii) the average assets of the target corporation. In computing this amount, intercompany assets are eliminated.

"Value of assets" means the value shown on the books and records of a corporation or other business entity using the method of accounting regularly used by that corporation or entity.

New section 612(b)(30) requires the taxpayer to add to federal adjusted gross income, in determining New York adjusted gross income, a portion of the total interest expense related to an acquisition. The requirements for making this modification are the same as those applicable to corporations discussed previously under Interest Addback.

The amount of the addback is 5% of interest paid or accrued during the tax years subject to a limitation amount. The limitation amount is computed as follows:

$$\text{Total aquisition related Interest deducted in computing New York adjusted gross income} \times \frac{\text{Cost of target corporation(s) acquired or value of assets acquired this year or three immediately preceding years}}{\text{Average total debt for the year}}$$

New Section 615(c)(7) provides a similar modification to New York itemized deductions. The taxpayer must reduce New York itemized deductions by 5% of the amount of acquisition-related interest deducted.

City of New York and City of Yonkers

The Administrative Code of theCity of New York has been amended to conform with the above changes to Article 22 of the Tax Law.

The amendments to Article 22 of the New York State Tax Law are also applicable to the city of Yonkers resident income tax surcharge authorized by Article 30-A of the Tax Law.