Overview of Current Events

Presented by:

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Today's Discussion Agenda

I. Overview of New York State Tax Changes

II. Federal Legislative Update

III. Tax Beneficial Provisions Relating to the Sale of a Small Business

IV. Section 338(h)(10) elections

2011 Maximum New York Tax Rates

- NY State – 8.97%
- NY City – 3.876%
- The maximum tax rate for New York State applies to taxable income in excess of $500,000.
  - If your taxable income is less than $500,000, the maximum tax rate is 7.85%.

Recent Legislation New York Tax Rates

- On December 8th legislation that passed both the NYS Assembly and Senate was presented to Governor Cuomo for signature (S.B. 50002). The highlights under the new law are as follows:
  - For Tax years beginning after 2011, a new top tax rate of 8.82% will be imposed on income of over $1M for unmarried individuals, $2M for married persons and surviving spouses, and $1.5M for heads of households. (Presently NY imposes a rate of 8.97% on income over $500K) Of note, under the new tax brackets, taxpayers with income under $1M will see a tax rate reduction.

2011 Maximum New York Tax Rates

- The highlights under the new law are as follows:
  - The MCTMT tax rate of .34% of payroll expense will be reduced to .11% for employers with payroll expense not greater than $375,000 per calendar quarter, and .23% for employers with payroll expense greater than $375,000 but not greater than $437,500 per calendar quarter. For employers with payroll expenses greater than $437,500 per calendar quarter, the rate remains at .34%. These rate changes will take effect with the calendar quarter beginning April 1, 2012.
  - Finally, for tax years beginning on and after January 1, 2012 and before January 1, 2015, the tax rate for qualified manufacturers will be reduced from 6.5% to 3.25%.

Bonus Depreciation

- New York State does not conform to federal rules regarding bonus depreciation which allows you to deduct 50% or 100% of the cost of qualifying property placed in service.
  - To the extent you take advantage of bonus depreciation on your federal return, either directly or from a pass-through entity, you will need to recompute your depreciation without applying the bonus depreciation rules

New York City UBT

- Self-employed persons working in New York City are subject to a 4% Unincorporated Business Tax ("UBT") if their unincorporated business taxable income exceeds $85,000
  - (after the maximum allowance for taxpayer's services of $10,000 (limited to 20% of UBT income) and a $5,000 exemption).
  - A partial credit is available if the UBT taxable income is between $85,000 and $135,000 (after the allowance and exemption).
  - New York City residents can claim a credit against their NYC personal income tax for a portion of the UBT paid by them, including their share of the UBT tax paid by a partnership.
    - The credit is 100% of the UBT paid if your taxable income is $42,000 or less, gradually declining as your income reaches $142,000, at which point the credit is limited to 23% of the UBT paid.
- Beginning in 2009, single sales factor is being phased in over 10 years.
  - For 2010, the allocation is 46% receipts, 27% payroll, 30% property.
  - For 2011, the allocation is 53%-23.5%-23.5%.

Adjustments to Allocation Requests

- Amendments to the Business Corporation Franchise Tax regulations update the administrative procedure for requesting a discretionary adjustment to the method of allocation.
- The effective date of the amendments is April 13, 2011.
- These amendments direct a taxpayer to submit its request in writing separate and apart from the filing of its report. A taxpayer's request may be submitted either before or after the filing of its report. Prior to these amendments, taxpayers were directed to make the requests with the filing of their reports.
- If consent is granted before the taxpayer files its report, the taxpayer may file using the approved methodology.
  - Otherwise, the taxpayer must file its report and compute its tax in accordance with the statutory formulas. If a taxpayer receives consent after filing its report, the taxpayer may then amend the report to reflect the approved method.

Credits Updates

- Excelsior Jobs Program Act
  - Chapter 61 of the Laws of 2011 extended the benefit period of the Excelsior Jobs Program from five to ten years.
  - Several other administrative changes were made to the program, as well as changes to how the credit is computed.
- Investment Tax Credit
  - Chapter 61 of the Laws of 2011 amended the Tax Law to extend the availability of the investment tax credit (ITC) for the financial services industry to property placed in service before October 1, 2015.
  - Before the amendment, the credit was only available for property placed in service before October 1, 2011
- Economic Transformation and Facility Redevelopment Program
  - This new program provides tax incentives to businesses to stimulate redevelopment in targeted communities where certain correctional or juvenile facilities are closed (economic transformation areas).

Marriage Equality Act

- The Marriage Equality Act (Act) was signed into law as Chapters 95 and 96 of the Laws of 2011, on June 24, 2011.
- One purpose of the Act is to provide that all marriages, whether of same-sex couples or different-sex couples, will be treated equally under all laws of the state. Accordingly, the Act applies to all taxes administered by the Tax Department as of the effective date of July 24, 2011
  - When necessary to implement the rights and responsibilities of spouses under the law, all gender-specific language or terms will be construed in a gender-neutral manner in all sources of law.
  - The Act applies to all legally performed marriages, whether or not the marriage took place in New York.

Offer In Compromise Program

- Under the new law, eligibility to participate in the Offer In Compromise Program has been expanded to include individual taxpayers who can prove that collection in full of any liability administered by the Tax Department will cause the taxpayer undue economic hardship.
- This expanded eligibility to participate in the Offer In Compromise Program is in addition to the existing criteria that allow a taxpayer to participate if the taxpayer has been discharged in a bankruptcy proceeding or is proven to be insolvent.
- Approval by a justice of the New York State Supreme Court is required for fixed and final liabilities where the amount to be compromised is over $100,000, exclusive of penalties and interest.
- These changes are effective August 17, 2011.

20-Year Statute of Limitations to Collect Tax Liabilities

- The Tax Law was amended to revise the 20-year statute of limitations on the Tax Department's time to collect tax liabilities that have been assessed and for which a notice and demand has been issued.
- The new law provides that a tax liability will not be enforceable and will be extinguished after 20 years from the first date a warrant could be filed by the department.
- This statute of limitations is applicable to all taxes, and any special assessments, fees, interest, additions to tax, penalties, or other impositions administered by the department.
- Under prior law, the 20-year period did not begin to run until a warrant was actually filed.
  - Further, the 20-year period was extended if the taxpayer acknowledged an indebtedness in writing, or made a payment towards the liability.

Sales Tax Issues

- E-Books/E-News
  - It is the Tax Department's current position that *e-books* meeting certain conditions (marketed as e-book, single download, etc) do not constitute information services subject to state and local sales and use taxes. Electronic news services and electronic periodicals that are not, in whole or substantial part, a listing, catalog, database, or compilation and that meet certain other requirements are also exempt.
- Groupon
  - The sale of certain vouchers by Web-based companies on behalf of businesses is not subject to sales or use tax at the time that the voucher is sold. However, sales or use tax is due at the time the voucher is redeemed with a vendor if the voucher is redeemed for taxable products or services.
- Manufacturer's Discounts
  - If an item purchased with a manufacturer's discount, the amount subject to sales tax is the full price of the item before subtracting the discount. For store discounts, however, the amount subject to sales tax is the price of the item after the discount is applied.

Sales Tax Personal Liability Partial Relief

- Section 1133 of the Tax Law usually imposes personal responsibility for payment of sales and use taxes on certain owners, officers, directors, employees, managers, partners, or members (responsible persons) of businesses that have outstanding sales tax liabilities.
  - A responsible person is jointly and severally liable for the tax owed, meaning the responsible person's personal assets could be taken by the Tax Department to satisfy the sales tax liability of the business.
- In the case of a partnership or LLC, each partner or member is a responsible person regardless of whether the partner or member is under a duty to act on behalf of the partnership or company.
- Under the department's new policy, the following limited partners and LLC members who are responsible persons may be eligible for relief if they can demonstrate that they were not under a duty to act in complying with the Tax Law:
  - Limited partners (of a limited partnership)
  - LLC members who can document that their ownership interest and percentage distributive share of the profits and losses of the LLC are each less than 50%

NYC Bulk Transfers of Co-ops and Condos

- The New York City Department of Finance has released a memorandum revising its position on the real property transfer tax rate that applies to "bulk transfers" of co-op apartments and residential condominium units in New York City. *Finance Memorandum*, "Real Property Transfer Tax on Bulk Sales of Cooperative Apartments and Residential Condominium Units," 00-6REV (N.Y.C. Dep't of Finance, Sept. 8, 2011).
- The issue stems from a two-tiered rate structure under the real property transfer tax ("RPTT") which applies, in part, to sales of co-op apartments and condominium units located in NYC. Transfers of an individual co-op or an individual condo unit are taxed at either 1% of the consideration (where the consideration is $500,000 or less) or 1.425% (if it is over $500,000).
  - For most other types of transfers of real property, the tax rate is 1.425% (where consideration is $500,000 or less) or 2.625% (if it is over $500,000).
- The Department applies the higher tax rate to what it refers to as "bulk sales," that is, transfers of more than one co-op apartment or condominium unit by a single grantor to a single grantee.

NYC Bulk Transfers of Co-ops and Condos (cont.)

- In 2000, the Department issued *Finance Memorandum*, 00-6 (N.Y.C. Dep't of Fin., June 19, 2000), in which it took the position that the transfer of adjacent co-op apartments or condominium units that were physically combined into a single unit *prior* to the transfer would not be treated as a "bulk sale," and would be taxed at the lower rates of 1% or 1.425%. However, if the units were not combined until *after* the transfer, the higher rates of 1.45% and 2.625% would apply.
- Subsequent decisions of the New York City Tax Appeals Tribunal have called into question the continued viability of the Department's policy, and the revised *Finance Memorandum* cites three City Tribunal decisions holding that certain transfers of multiple condominium units to a single grantee were not "bulk sales" and thus qualified for the lower tax rate.
- However, rather than set out a revised policy in light of those decisions, the revised *Finance Memorandum* merely states that "the facts and circumstances differ in each case," and that if it is unclear whether transfers qualify for the lower rate under these decisions, "the Department recommends that you request a letter ruling to get the Department's opinion."

Matter of Kellwood

- The New York State Tax Appeals Tribunal upheld the forced combination of an out-of-state factoring subsidiary with its parent apparel manufacturer.
- Based on a "sham transaction" analysis, the Tribunal held that the transactions under which the factoring subsidiary was formed and operated "do not merit tax respect," and therefore the taxpayer failed to rebut the presumption of distortion resulting from substantial intercorporate transactions under the pre-2007 law.
  - Taxpayer did not dispute that the ownership and unitary business requirements for combination were met or that there were substantial intercorporate transactions. The sole issue was whether the taxpayer successfully rebutted the "presumption of distortion of taxation" that tax law assume, and thus avoids forced combination.
- *Matter of Kellwood Company*, DTA No. 820915 (N.Y.S. Tax App. Trib., Sept. 22, 2011).

Legislative Update

- Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010
  - Enacted December 17, 2010
  - Extended Bush tax cuts that were scheduled to expire December 31, 2010
  - Expiring credits were expanded through 2012
  - Patch for AMT
  - Depreciation
  - Estate and Gift tax

Legislative update

- February 2011, President Obama releases his budget for FY 2012
  - Earlier policies were repeated
  - Proposed $3.73 trillion in federal spending and $1.1 trillion in deficit reductions
  - Nothing happened

Legislative update

- In August 2011, President Obama signed the Budget Control Act
  - Raised debt limit to avoid a projected August 2 default
  - Created a bipartisan joint select committee
    - Mandate is to draft additional deficit reduction legislation in time to be voted on by Congress before year end
    - The amount of deficit reduction had to be at least $1.5 trillion over 10 years
  - If this failed, automatic spending cuts would apply

Legislative update

- In September 2011, President Obama proposed the American Jobs Act
  - The $447 billion legislation would increase the temporary payroll tax cut to 3.1% for 2012 and expand it to the employer share of the first $5 million in wages.
  - Other payroll tax breaks and tax credits for hiring certain classes of employees
  - Extend 100% bonus depreciation
  - Revenue offsets would come from closing loopholes for oil companies, tax hikes for affluent individuals and corporations and tax carried interests
  - Proposal died

Legislative update

- On September 19, 2011, President Obama unveiled the $3 trillion federal budget Deficit Reduction Plan which included $1.5 trillion in tax increases.
  - 5 principles of tax reform
  - Joint Select Committee will consider this proposal and others

Legislative update

	Democrats	Republicans
Senate members	•Patty Murray, Washington, *Co-Chair* •Max Baucus, Montana •John Kerry, Massachusetts	•Jon Kyl, Arizona •Rob Portman, Ohio •Pat Toomey, Pennsylvania
House members	•Xavier Becerra, California •Jim Clyburn, South Carolina •Chris Van Hollen, Maryland	•Jeb Hensarling, Texas, *Co-Chair* •Fred Upton, Michigan •Dave Camp, Michigan

Legislative update

- October 2011, President Obama's American Jobs Act was introduced into Congress with some modifications
- The Act did not pass

Legislative update

- Super Committee recommendations due November 23, 2011. The Super Committee's failure to failure to arrive at a consensus sets up a significant fight over the payroll tax cut and benefits for the unemployed.
- Goldman Sachs economic forecaster Alec Phillips estimated that allowing the payroll tax cut to expire would reduce growth by as much as two-thirds of a percentage point in early 2012.
- Macroeconomic Advisers estimates that it would reduce GDP growth by 0.5 percent and cost the economy 400,000 jobs by the 4th qtr.

Other considerations

- European influence
  - PIIGS are having difficulty coping with the debt that years of deficit spending has created
  - Market conditions have been in turmoil

Small Business Corporations – Equity Investments

- Three provisions of the Code give preferential treatment to equity investments in small business corporations.
  - Section 1045 allows the tax-deferred rollover of gain realized on the sale of stock of one qualified small business corporation into stock of another qualified small business corporation.
  - Section 1202 allows an exclusion for gains recognized with respect to stock of qualified small business corporations.
  - Section 1244 allows ordinary loss treatment with respect to the stock of small business corporations.

Small Business Corporations – IRC §1244

- Section 1244 gives ordinary loss treatment to:
  - Individuals (directly or through partnerships);
  - Who recognize a loss on §1244 Stock;
  - That was originally issued to them;
  - For money or property;
  - By a domestic small business corporation.
- In any single taxable year the amount of loss that an individual may treat as ordinary loss under §1244 — whether the §1244 Stock was issued by one or more corporations — may not exceed $50,000 ($100,000 in the case of a joint return).
- Section 1244(a) provides that a loss sustained by a partnership on §1244 Stock issued to it may also qualify as an ordinary loss. Regulations clarify that ordinary loss treatment is available only to partners that are individuals

Small Business Corporations – IRC §1244

- The benefits of §1244 are available only to individuals and partnerships who acquire the stock at original issuance.
  - Treasury regulations provide that "[a]n increase in the basis of outstanding stock as a result of a contribution to capital is not treated as an issuance of stock under [§]1244."
- However, it IS possible to convert a partnership into a corporation in such a way as to retain the possibility of taking advantage of §1244:
  - The partnership could transfer its assets directly to the corporation in exchange for its stock. Subsequently it would either retain the stock or terminate and distribute its stock.
  - The partners could transfer their partnership interests to the corporation in exchange for stock.
  - The partnership could distribute its assets to the partners, who would in turn contribute them to the corporation in exchange for its stock.

Small Business Corporations – IRC §1244

- Treasury regulations allow §1244 treatment for "a loss on the sale or exchange (including a transaction treated as a sale or exchange, such as worthlessness) of '[§]1244 stock' which would otherwise be treated as a loss from the sale or exchange of a capital asset… ."
  - The worthlessness of stock, and potentially the liquidation of the issuer or redemption of the stock, would be treated as "sales or exchanges" and, therefore, "sales" for purposes of §1244.
- Although the liquidation of an insolvent corporation is generally an occasion to claim ordinary loss treatment under §1244, that treatment is not available if the insolvent corporation issued the stock at a time when it had already adopted a plan of liquidation, or ceased business operations, and used the cash received to repay debts owed to outside creditors or shareholders.

Small Business Corporations – IRC §1244

- If a taxpayer receives §1244 Stock in exchange for property with a built-in-loss in an exchanged basis transaction, the taxpayer may not use §1244 to convert the built-in-loss into an ordinary loss

Small Business Corporations – IRC §1045

- Section 1045 allows a taxpayer to sell Qualified Small Business ("QSB") stock without recognizing gain if the taxpayer rolls that gain over into new QSB stock within a 60-day period beginning on the date of the sale.
- Gain on the sale of QSB stock may qualify for this rollover treatment only if the following conditions are satisfied:
  - The taxpayer is not a corporation;
  - The taxpayer sells the stock;
  - The taxpayer has held the QSB stock more than six months at the time of the sale; and
  - The taxpayer elects to apply the provisions of §1045.
- If all of those conditions are satisfied, the taxpayer recognizes gain from the sale only to the extent that the amount realized on the sale of the QSB stock exceeds the cost of any QSB stock purchased by the taxpayer during the 60-day period beginning on the date of the sale, reduced by any portion of that cost already used to shelter the amount realized with respect to the sale of other QSB stock.

Small Business Corporations – IRC §1045

- To the extent that gain goes unrecognized because of this provision, it reduces the taxpayer's basis in the QSB stock purchased. The unrecognized gain from the sale of QSB stock is applied to reduce the bases of QSB stock purchased during the 60-day period beginning on the date of sale of QSB stock. If the taxpayer purchases QSB stock on more than one occasion during the 60-day period, the unrecognized gain reduces the bases in the same order that the purchases occur.
- A taxpayer seeking the rollover benefits of §1045 must make an election on or before the due date (including extensions) for filing the income tax return for the taxable year in which the QSB stock is sold.

Qualified Small Businesses

- §1202(d) defines a “Qualified Small Business
- Only a domestic C corporation is eligible to be a QSB
- Gross Asset tests:
  - The aggregate gross assets of the corporation (or any of its predecessors) must not have exceeded $50,000,000 at any time on or after August 10, 1993 and before the issuance of the stock for which preferential treatment is sought
    - “aggregate gross assets” means the amount of cash plus the aggregate adjusted bases of other property held by the corporation
  - Immediately after the issuance, the aggregate gross assets of the corporation — including amounts received by the corporation in the issuance — must continue to be no more than $50,000,000
- For purposes of determining whether a corporation is a QSB, all corporations that are part of the same parent-subsidiary controlled group are treated as one corporation

Small Business Corporations – IRC §1202

- For taxpayers other than corporations, §1202 excludes from gross income at least 50% of gain recognized on the sale or exchange of QSB stock held for more than five years
- In most circumstances the gain exclusion is 50%
  - 75% for QSB stock acquired after February 17, 2009, and before September 28, 2010, and
  - 100% for QSB stock acquired after September 27, 2010, and before January 1, 2012,
  - Exception: QSBs that conduct business in “empowerment zones”.

IRC §1202 Limitations

- For each tax year, with respect to each corporation in which the taxpayer sells or exchanges QSBS, the amount of gain eligible for the exclusion may not exceed the following amounts:
  - 1) Except in the case of married individuals filing separate returns: the greater of
    - (a) $10 million, less the total amount of eligible gain (as defined below) taken into account under these rules by the taxpayer with respect to dispositions of stock issued by the corporation in all earlier tax years, or
    - (b) ten times the taxpayer's total adjusted basis in QSBS of the corporation disposed of by the taxpayer in the tax year
  - 2) In the case of married individuals filing separate returns: the same limitation as above, except with $5 million substituted for $10 million

Small Business Corporations – IRC §1202

- A taxpayer must hold QSB stock for more than five years to be eligible for the partial exclusion under §1202.
  - If a taxpayer acquires QSB stock in exchange for property (other than money or stock), the taxpayer is deemed to have acquired the stock on the date of the exchange.
  - If QSB stock is converted into other stock of the same corporation, the newly acquired stock is also treated as QSB stock and the holding period of the prior stock tacks for purposes of the five-year holding requirement.
  - If a taxpayer receives QSB stock as a gift or by death, the taxpayer tacks the holding period of the transferor from which it receives the stock.
  - If a taxpayer receives QSB stock from a partnership in which the taxpayer is a partner, the partner tacks the partnership's holding period.

Business Equipment

- Section 179 expensing rules allow up to $500,000 deduction of qualifying property placed in service during taxable years beginning in 2011.
  - Rule only applies if the total amount of qualifying property placed in service in 2011 does not exceed $2MM. Partial deduction between $2MM and $2.5MM
- Section 179 expensing is also available for qualified real property placed in service in tax years beginning in 2011.
  - Maximum amount allowed under these rules is $250,000, and this amount reduced the gross § 179 amounts allowed
- 100% bonus depreciation applies for qualified investments made between Sept 9, 2010 and Dec. 31, 2011.

Net Operating Loss Carrybacks

- Under the Worker, Homeownership, and Business Assistance Act of 2009, NOLs generated in tax years ending after 12/31/07 and beginning before 1/1/10 were subject to an election to carryback for up to five years.
- Net Operating Losses generated after January 1, 2010 are only allowed the normal two year carryback.

Deferral of Cancellation of Indebtedness Income

- The American Recovery and Reinvestment Act of 2009 provides a debtor the ability to elect to recognize COD income ratably over a five year period.
- A debtor can elect to recognize and report COD income from "reacquisition" of an "applicable debt instrument" that occurs after Dec. 31, 2008 and before Jan. 1, 2011
  - "Reacquisition" – An acquisition of the debt instrument by the debtor or related party that issued the debt.
    - Includes a cash purchase of the debt, exchange of debt for new debt, exchange of debt for stock or partnership interest, contribution of debt to capital, forgiveness of total debt.
  - Note that personal debt does not qualify.
- Reacquisitions occurring in either 2009 or 2010 have the COD income reported ratably over five years starting in 2014.

§338(h)(10) Election Overview

- If a §338(h)(10) election is made for a target, old target generally is deemed to have sold all of its assets to new target and to have distributed the proceeds to the old target shareholders immediately before the target ceases to exist (generally in a deemed liquidation).
  - In effect, the sale of target stock is ignored for federal income tax purposes, which generally allows for the single level of federal income tax that is the hallmark of the §338(h)(10) election.
- The principal effect of a §338 election on Target ("T") is that T's aggregate basis in its assets is "stepped up" under §1012 to the price that Purchaser ("P") paid for T's stock (adjusted for assumed liabilities and other items).

§338(h)(10) Eligibility

- A §338(h)(10) election can be made only if a qualified stock purchase is accomplished (80% vote and value via 1504(a)(2)) and the target is
  - (i) a domestic corporation that is a subsidiary member of a consolidated group,
  - (ii) a domestic corporation that is a subsidiary member of an affiliated group not filing a consolidated return, or
  - (iii) an S corporation.
    - For an S corporation to qualify as a target for purposes of a §338(h)(10) election, the purchasing corporation cannot purchase any target stock before the acquisition date.
      - Such a purchase terminates the S election for the target.

§338(h)(10) Motivations

- If an acquiring corporation purchases stock of a target corporation from the target's parent, the §338(h)(10) election is often desirable.
- The parent will not recognize gain or loss on the sale of the target's stock, and the target will recognize gain or loss as if it sold its assets.
  - The treatment of the parent's stock sale as an asset sale allows the parent to dispose of the sub with only one tax at the corporate level, even though the purchaser obtains a stepped-up basis in the assets.
  - A §338(h)(10) election is advantageous if
    - i) the purchase price is allocable to depreciable assets or amortizable §197 intangibles or
    - ii) the unrealized appreciation in T's assets is less than the unrealized appreciation in Parent's stock in T.

§338(h)(10) Mechanics

- If a §338(h)(10) election is made old target is deemed to transfer all of its assets to an unrelated person (i.e., new target) in exchange for consideration that includes the discharge of old target's liabilities in a single transaction at the close of the acquisition date (but before the deemed "liquidation" of old target).
  - Old target recognizes all of the gain realized on the deemed transfer of its assets in consideration for the "aggregate deemed sale price" (ADSP). Old target realizes the deemed sale tax consequences before the close of the acquisition date.
    - Gain or loss from the deemed asset sale for a consolidated target is included in the consolidated return filed by the selling consolidated group for the tax year that includes the acquisition date.
    - An S corporation target for which a §338(h)(10) election is made files a final return for the entire short S corporation year.
  - The purchasing corporation takes a cost basis in recently purchased target stock under §1012, and is automatically deemed to have made a gain recognition election for any nonrecently purchased target stock.

§338(h)(10) S Corp Mechanics

- Any direct or indirect subsidiary of an S corporation target that the target has elected to treat as a Qsub remains a QSub through the close of the acquisition date.
  - The regulations provide no specific guidance on §338(h)(10) elections in cases in which a QSub itself is the target.
- The sale by an S corporation of all of the stock of a QSub generally is treated as an asset sale by the S corporation to the purchaser of the QSub stock.

§338(h)(10) Tiered Mechanics

- If old target is the parent of a chain of subsidiaries for which §338(h)(10) elections are made, the deemed asset sale of old target is deemed to precede that of its subsidiary.
- As a consequence of this “top-down” cascade, each deemed sale and purchase of the stock of a target subsidiary may result in a qualified stock purchase (assuming the requisite stock ownership).
- No deemed §338(h)(10) election is made for lower tier target subsidiaries, but an affirmative election is possible on a subsidiary by subsidiary basis.

§338(h)(10) Election Filing

- The §338(h)(10) election must be made
  - i) jointly by the Purchaser and Seller on Form 8023
  - ii) not later than the 15th day of the 9th month beginning after the month that includes the acquisition date, and
  - iii) is irrevocable

§338(h)(10) – New York State

- Since 1991, New York State has adhered to the federal treatment of IRC §338(h)(10) elections, regardless of the composition of the New York group.
  - Federal consolidated return effects of IRC §338(h)(10) elections are irrelevant for purposes of New York reporting.
- Effective for tax years beginning on or after January 1, 2007, if a N.Y. nonresident is a shareholder in an S corp that has made the election to be a N.Y. S corp, and the S corp has made an election under IRC section 338(h)(10), then any gain recognized on the deemed asset sale for federal income tax purposes will be treated as N.Y. source income. The amount of the gain to be included in N.Y. source income is determined using the applicable allocation percentage in effect for the year that the section 338(h)(10) election was made.
  - TSB-M-10(10)I, 8/31/10

§338(h)(10) – New York State (cont)

- In addition, when a nonresident shareholder exchanges his or her S corp stock as part of the deemed liquidation, any gain or loss recognized on the stock sale for federal income purposes will be treated as the disposition of an intangible asset for N.Y. State purposes and will not increase or offset any gain recognized on the deemed asset sale as a result of the section 338(h)(10) election. Therefore, the gain or loss from the deemed liquidation of S corp stock is not included in N.Y. source income.
  - New York Technical Service Bureau Memorandum TSB-M-10(10)I, 08/31/2010

§338(h)(10) – New York City

- Amendments to the general corporation tax rules provide that the Department of Finance will recognize IRC §338(h)(10) elections for purposes of entire net income (ENI) calculations and return filing, unless the target corporation is an S corporation for federal income tax purposes.
  - These amendments apply to all open years. RCNY §11-27(h)-(j)
- The federal taxable income of the target corporation, for purposes of computing ENI, will include any gain or loss on the deemed asset sale by the target corporation recognized by virtue of the election.
- The federal taxable income of a member of the selling consolidated group, for purposes of computing ENI, does not include the gain or loss on the target corporation's sale or exchange of stock not recognized by virtue of the election.

§338(h)(10) – New York City (cont)

- Because the starting point for determining the entire net income of an S corporation is the taxable income that the corporation would have been required to report for Federal tax purposes had no S election been made, any 338(h)(10) election made with respect to a target corporation that is an S corporation for Federal tax purposes will be deemed to be an invalid election and will not be recognized.
- If a section 338(h)(10) election of an S corporation is not recognized, the corresponding election pursuant to section 338(g) will be deemed invalid and will not be recognized
  - As a consequence of the nonrecognition of the section 338(g) election, the basis of the assets of the target corporation will be determined without regard to any adjustments made pursuant to section 338(b).

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