Instructions for Schedule M (Form NYC-3L)

FINANCE
NEW • YORK

Merger, Acquisition and Consolidation Report

1996

GENERAL INFORMATION

Chapter 241 of the Laws of 1989 amended Section 11-602 of the Administrative Code of the City of New York in part to limit tax benefits associated with certain business restructuring. The provisions are effective for tax years beginning on or after January 1, 1989, but apply only to transactions completed on or after July 1, 1989.

Unless the restructuring transaction is specifically excluded, the following tax consequences result:

- In the case of a highly leveraged transaction, the acquiring corporation loses the benefit of the target corporation's unused net operating loss available to be carried forward, and up to 5% of the total interest expense of the acquirer or the affiliated group may be a required addback in the computation of New York City taxable income.
- In any acquisition, whether or not highly leveraged, where 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.

An excluded transaction is:

- an acquisition which occurs solely by reason of a redemption of stock to the extent that the redemption qualifies under Section 303 of the Internal Revenue Code; or
- an acquisition 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 is any person as defined in Section 7701(a)(1) of the Internal Revenue Code, and except that references to at least eighty percent should be read as more than fifty percent; or
- an acquisition 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 those employees or their beneficiaries. Control, in this context, refers to
  1. ownership of more than fifty percent of the total voting power in a corporation, or
  2. total employees' interest (within the meaning of Section 704(b) of the Internal Revenue Code) of more than fifty percent of a partnership;

or

- a merger or consolidation in which 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 is any person, as defined in Section 7701(a)(1) of the Internal Revenue Code, and except that references to at least eighty percent in such Section 1504 should be read as more than fifty percent.

DEFINITION OF TERMS

Corporate Merger - A procedure composed of the merging of two or more constituent corporations into a single corporation which is one of the constituent corporations, under Article 9 of the New York State Business Corporation Law, the corresponding statutes of other states and/or the corresponding statutes of foreign nations. 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.

Corporate Consolidation - A procedure composed of the consolidation of two or more corporations into a single corporation which is a new corporation to be formed pursuant to the consolidation, under Article 9 of the New York State Business Corporation Law, the corresponding statutes of other states and/or the corresponding statutes of other foreign nations. 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.

Corporate Acquisition - The purchase and/or other acquisition (including redemption) on an acquisition date by a person (the "acquiring person"), as the term 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 the acquisition the person owned fifty percent or less, and immediately thereafter owned more than fifty percent of the total voting power of the target corporation. A corporate acquisition does not include an excluded transaction.

SPECIFIC INSTRUCTIONS

PART 1

General Information

This section identifies the parties to a merger, consolidation or acquisition and determines whether tax consequences result for participants in the transaction.

LINE 1

Check the appropriate box to indicate the type of transaction.

LINE 2

Indicate the date the transaction was completed. If the date is before July 1, 1989, the new law provisions do not apply to this transaction and this schedule does not have to be completed. Provide the name and identification number requested at the top of the form and attach a copy of the schedule to your tax return, Form NYC-3L.

LINE 3

Indicate your role in the merger, acquisition or consolidation and list the names of the other participants. If you need more room to list the members of an affiliated group, attach a separate sheet.

LINES 4, 5 AND 6

Excluded transactions - If you answered "Yes" at lines 4, 5 or 6, do not complete the rest of this schedule. Provide the names and identification numbers requested at the top of the form and attach a copy of the form to your tax return. If you answered "No" at lines 4, 5 and 6, complete parts 2 and 3.

PART 2
Acquirer Information

LINE A1
Include total interest of the acquirer during the year in which the acquisition occurred.

LINE A2
The value of the assets acquired is the value shown on the books and records of the target corporation, using the method of accounting regularly used by the target. (Administrative Code Section 11-602(b)(6-a)(A)(2)) Respond in the affirmative only if the taxpayer acquired: (i) all or 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 any similar statute of any other state or foreign nation, or (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 eighty percent of the assets of such other corporation (as of the date eighteen months prior to such acquisition date) and immediately thereafter owned eighty percent or more of such assets (other than assets disposed of by such other corporation in the usual or regular course of business actually conducted by such corporation) but in either case only where the value of the assets (valued at cost) so acquired is in excess of five million dollars and only where such acquisition occurred on or after July 1, 1989.

LINE A3
Base your answer on the target corporation's total business, investment and subsidiary capital immediately prior to the merger or acquisition.

LINE A4
An affiliated group is a group as defined in Section 1504 of the Internal Revenue Code except that:

- references to at least eighty percent in such Section 1504 should be read as more than fifty percent.
- Section 1504 should 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 these foreign corporations are included only to the extent that they are effectively connected with the conduct of a trade or business within the United States).
- Section 1504 should be read without regard to the exclusion provided for in Section 1504(b)(4).

If you answered "NO" at lines A1, A2, A3 and A4 or B <u>and</u> C, complete part 5 only.

If you answered "YES" at lines A1, A2, A3 or A4 <u>and</u> B, complete part 3 to determine if interest deducted must be added back.

If you answered "YES" to C, complete part 3 to determine if the taxpayer which was a target corporation in a corporate acquisition or is the surviving corporation of a corporate merger, or the consolidated corporation in a corporate consolidation, will be allowed to deduct NOLs sustained by the target(s) in years prior to the merger, acquisition or consolidation.

PART 3
Ratio Computation

Use this worksheet to compute the combined acquirer and target corporations' debt-to-equity ratio and the debt-to-assets ratio for the year in which the corporate acquisition, acquisition of assets, corporate merger or corporate consolidation occurred and for the taxable year prior to the acquisition, merger or consolidation. The difference between these two ratios should then be indicated on the worksheet.

This worksheet will also determine if the transaction is a highly leveraged corporate acquisition or highly leveraged corporate merger or corporate consolidation.

In any case in which the acquiring person (or the surviving or consolidated corporation) is a member of an affiliated group, all members of the group are treated in the aggregate as the acquiring person for purposes of this part.

The debt-to-equity ratio and the debt-to-asset ratio of an affiliated group are determined for the entire group. The prior year's ratio should include the target as well.

A. CORPORATE ACQUISITIONS
A highly leveraged corporate acquisition is a corporate acquisition in which

- the acquirer's ratio of average aggregate debt to average aggregate equity for the tax year in which the acquisition occurred increases by more than 100% over the ratio for the immediately preceding tax year; and
- the ratio of average aggregate debt to average aggregate assets for the tax year in which the acquisition occurred increased by more than 60% over the ratio for the immediately preceding tax year; and
- the total of the acquiring person's interest paid or accrued or the interest paid or accrued by the affiliated group of which the acquiring person is a member during the tax year in which the acquisition occurred is more than $1 million.

Average aggregate debt for a given taxable year is the sum of:

1. the average debt of the acquirer; plus
2. the average debt of the target corporation (unless the target corporation is a member of an affiliated group which includes the acquirer).

In computing average aggregate debt, intercompany debt should be eliminated.

Average aggregate equity for a given taxable year is the sum of:

1. the sum of the average equity of the acquirer; plus
2. the sum of the average equity of the target corporation (unless the target corporation is a member of an affiliated group which includes the acquirer).

In computing average aggregate equity, intercompany equity should be eliminated.

Average aggregate assets for a given taxable year is the sum of:

1. the average assets of the acquirer; plus
2. the average assets of the target corporation (unless the target corporation is a member of an affiliated group which includes the acquirer).

In computing average aggregate assets, intercompany assets should be eliminated. The value of assets is the value shown on the books and records of a corporation using the method of accounting regularly used by the corporation.

B. CORPORATE MERGERS AND CONSOLIDATIONS
A highly leveraged corporate merger or corporate consolidation is one in which the tax-

payer is the surviving or consolidated corporation and:

- such corporation's ratio of average aggregate debt to average aggregate equity, for the tax year in which the merger or consolidation occurred, increased by more than 100% over such ratio for the immediately preceding tax year; and
- such corporation's ratio of average aggregate debt to average aggregate assets, for the tax year in which the merger or consolidation occurred, increases by more than 60% over such ratio for the immediately preceding tax year; and
- total interest paid or accrued by the surviving or consolidated corporation or by the affiliated group of which the surviving or consolidated corporation is a member during its tax year in which the merger or consolidation occurred is more than $1 million.

Average aggregate debt for a given taxable year is the sum of:

1. the average debt of the taxpayer, plus
2. the sum of the average debt of each of the constituent corporations.

In computing the average aggregate debt, intercompany debt should be eliminated.

Average aggregate equity for a given taxable year is the sum of:

1. the average equity of the taxpayer, plus
2. the average equity of each of the constituent corporations.

In computing average aggregate equity, intercompany equity should be eliminated.

Average aggregate assets for a given taxable year is the sum of:

1. the average assets of the taxpayer, plus
2. the average assets of each of the constituent corporations.

In computing average aggregate assets, intercompany assets should be eliminated.

The value of assets is the value shown on the books and records of a corporation using the method of accounting regularly used by the corporation.

PART 4
Highly Leveraged Transaction Modifications

SCHEDULE A AND SCHEDULE B
The interest addback and net operating loss carryforward denial provisions apply to highly leveraged transactions and are triggered by changes in debt-to-assets and debt-to-equity ratios in the acquisition year. *(Refer to part 3.)*

Schedule A must be completed only if the answer is "yes" to: (i) question C of Part 2 and (ii) both questions 1 and 2 of Part 3.

Schedule B must be completed only if the answer is "yes" to: (i) any of questions A1, A2, A3, or A4 of Part 2; (ii) question B of Part 2, and (iii) both questions 1 and 2 of Part 3.

Others are not subject to any modifications of NOLs or interest addback and need not complete Part 4.

SCHEDULE B LINE 1
Cost of target includes total costs incurred:

- in a stock acquisition, the acquirer's total cost of any target corporation or corporations acquired in an acquisition year or during the three immediately preceding tax years;
- in an asset acquisition, the value of assets acquired during an acquisition year or in the three immediately preceding tax years, but only if such acquisition took place on or after July 1, 1989; and
- in a corporate merger or consolidation, the total business, investment and subsidiary capital of target corporations which were constituent corporations during the tax year or in the three immediately preceding tax years.

LINE 2
The total average debt is the average aggregate debt determined for the current taxable year in the manner provided in part 3 for the applicable transaction. If the acquiring person or the surviving or consolidated corporation is a member of an affiliated group, all members of the group are treated as the taxpayer.

LINE 4
Total interest expense includes interest paid or accrued by the taxpayer during the tax year, to the extent deducted in the computation of entire net income (i.e., net of any interest required to be added back under other provisions of Subchapter 2 of Chapter 6 of Title 11 of the Administrative Code).

For purposes of completing this part of the form, the value of assets is the value shown on the books and records of a corporation using the method of accounting regularly used by the corporation.

PART 5
Subsidiary Capital / Income Adjustments

The taxpayer must complete Part 5 if it was required to complete Part 2.

LINES 1 THROUGH 12
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 to retain subsidiary capital treatment for interest, dividends and gains received from the target. Additionally, the target cannot sell or otherwise dispose of 50% or more 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 or disposition. 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 stock sales. In addition, entire net income must be determined without the exclusion, deduction or credit of dividends from a target corporation which are received on or after the acquisition date and prior to the first day of the taxable year in which the disposition occurred. In both situations, a 50% dividend deduction is not allowed. For asset disposition, loss of subsidiary capital treatment continues for 18 months following the disposition. Stock sales result in such treatment as long as the stock owned stays below 50%.