June 30, 1999

Re: Ruling Request

General Corporation Tax
Banking Corporation Tax
FLR 984735-006

Dear :

This letter responds to your request, dated , for a ruling submitted on behalf of . (the "Taxpayer") applying the New York City Banking Corporation Tax (the "BCT") and General Corporation Tax (the "GCT") to the facts presented below. This office received additional information relating to this request on .

FACTS

The facts presented are as follows:

The Taxpayer and (the "Partner") were incorporated in on as wholly owned subsidiaries of (the "Savings Bank"). The Savings Bank, a savings bank authorized to do business under article 6 of the New York State Banking Law, formed the Taxpayer and the Partner to own and operate real estate. Pursuant to an agreement dated , the Taxpayer and the Partner formed (the "Partnership"), also to own and operate real estate. The Taxpayer and the Partner were general partners in the Partnership and each had and continues to have a percent interest in the capital, assets, profits and losses, and cash flow of the Partnership.

The Taxpayer, the Partner, and the Partnership acquired various parcels of real estate through foreclosure proceedings. By , all the parcels of real estate directly owned by the Taxpayer and the Partner had been sold. The Partnership continued to own buildings, both of which were originally acquired in . Those buildings were later converted to cooperatives and the Partnership continues to own sponsor shares in those buildings.

Before 1985 the Taxpayer filed its returns under the GCT. The BCT was amended effective for 1985 tax years. To make the election under section 11-640(d) of the New York City Administrative Code (the "Code") that would allow it to continue to be taxed under the GCT, the Taxpayer filed its 1985 return under the GCT. It has continued to file GCT returns since that time.

On , (the "Commercial Bank"), a corporation registered as a bank holding company under the Federal Bank Merger Holding Company Act of 1956, purchased all the stock of the Taxpayer. At that time, the only business in which the Taxpayer was engaged was through the Partnership.

On , the Commercial Bank merged into (the "Merger Sub"), a wholly owned subsidiary of (the "Merger Parent") under a reorganization plan. As part of that plan, shareholders of the Commercial Bank changed exchanged their shares of the Commercial Bank for shares of Merger Parent. Merger Sub, a corporation registered as a bank holding company under the Federal Bank Holding Company Act of 1956, changed its name to that of Commercial Bank. Merger Parent, also a corporation, became a bank holding company and changed its name to ("Holding Company"). Holding Company files a consolidated return with the Commercial Bank.

You have told us that the Taxpayer will be involved in one or more transactions fitting one or more of the following three scenarios:

- Scenario 1. One or more corporations with which the Commercial Bank files a consolidated federal income tax return will merge into the Taxpayer

under section 907 of the New York State Business Corporation Law ("BCL"). In the merger as you propose it, the Taxpayer will be the surviving corporation.[1]

❖ Scenario 2. The Taxpayer will be transferred to Holding Company or to a subsidiary of Holding Company with which Holding Company files a consolidated federal income tax return. Following that transfer, one or more corporations with which the Commercial Bank and Holding Company file a consolidated federal income tax return will merge with the Taxpayer. The Taxpayer will be the surviving corporation following the merger.

❖ Scenario 3. Following scenario 1 or 2, certain business activities currently conducted by subsidiaries of the Commercial Bank or Holding Company will be transferred to the Taxpayer.

You have represented that the business purpose to be achieved by scenarios 1, 2, and 3 is to remain competitive with other corporations doing a similar business in New York City and to minimize expenses of tax compliance and administration.

---

[1] You have represented that on , the Taxpayer merged with (the "Merged Affiliate"), a corporation. The Merged Affiliate files a consolidated federal income tax return with the Commercial Bank. The Taxpayer and the Merged Affiliate merged under BCL section 907, and the Taxpayer was the surviving corporation. Following the merger, the Taxpayer changed its name to Merged Affiliate; references to the Taxpayer in this ruling, however, apply to the corporation both before and after that name change.

The conclusions and discussion in this ruling with respect to scenario 1 will apply to the , merger of the Taxpayer and the Merged Affiliate.

ISSUE

You have requested a ruling that the Taxpayer's 1985 election under Code section 11-640(d) to be taxed under the GCT will not be affected by the events described in scenarios 1, 2, or 3.

CONCLUSION

Based on the facts presented and representations submitted, we have determined that, assuming that the Taxpayer's 1985 election under Code section 11-640(d) to be taxed under the GCT was validly made, that election will not be affected by the events described in scenarios 1, 2, or 3.

This ruling does not address whether the election that the Taxpayer made in 1985 under Code section 11-640(d) to be taxed under the GCT was a valid election.

DISCUSSION

The BCT is imposed on the entire net income of "banking corporations" that do business in the City. Code § 11-639. The GCT is imposed on corporations that do business, employ capital, own or lease property, or maintain an office in the City. Code § 11-603. Under Code section 11-603.4(a), corporations subject to the BCT are exempt from the GCT. Code section 11-640 identifies those corporations that are "banking corporations" and thus subject to the BCT and not the GCT.

Code section 11-640(a)(9) provides that, under certain circumstances, a corporation can be a banking corporation and therefore subject to the BCT, even though it would not otherwise be a banking corporation. Generally, it provides that a corporation can be a banking corporation if 65 percent or more of its stock is owned or controlled by a banking corporation and the corporation is:

> Principally engaged in a business ... which (i) might be lawfully conducted by a corporation subject to article three of the banking law or by a national banking association or (ii) is so closely related to

> banking or managing or controlling banks as a proper incident thereto, as set forth in paragraph eight of subsection (c) of section four of the federal bank holding company act of [1956], as amended.

Chapter 298 of the Laws of 1985 amended Code section 11-640(a)(9) in several respects: it reduced from 80 percent to 65 percent the percentage of voting stock of a subsidiary that must be owned or controlled by a bank or bank holding company; it included a subsidiary of a corporation that was created to do business under article six (savings banks) or article ten (savings and loan associations) of the Banking Law; and it eliminated the requirement that the subsidiary must file a consolidated return with the parent (the "1985 Amendments"). See TSB-M-85(16)C, February 10, 1986 (explanation of the corresponding changes made to the New York State Franchise Tax on Banking Corporations). As a result of those changes, many subsidiaries that were not "banking corporations," and therefore subject to the GCT rather than the BCT before the amendments, became subject to the BCT.

To preserve the tax status of corporations subject to the GCT, rather than the BCT before the 1985 Amendments, those amendments also included a grandfather provision, set forth in Code section 11-640(d), under which corporations that had been subject to the GCT before the 1985 Amendments could elect to continue to be taxed under the GCT rather than the BCT (the "Grandfather Provision").

The Grandfather Provision provides that:

> Notwithstanding the provisions of this part [the BCT], all corporations of classes now or heretofore taxable under [the GCT] shall continue to be taxable under [the GCT], except: ... (3) banking corporations described in paragraph nine of subdivision (a) of section 11-640. Provided, however, that a corporation described in paragraph three of this subdivision which was subject to [the GCT] during [1984] may, on or before the due date for filing its return ... for its taxable year ending during [1985], make a one time election to continue to be taxable under [the GCT]. Such election shall continue to be in effect until revoked by the taxpayer. In no event shall such

election or revocation be for part of a taxable year.

Code section 11-640(d) provides that an election made under the Grandfather Provision will continue to be in effect until revoked by the taxpayer. See TSB-M-85(16)C, February 10, 1986. Under section 3-01(b), definition of Banking Corporation, subparagraph (x)(B), of Title 19 of the Rules of the City of New York ("RCNY"), an election under the Grandfather Provision is made by filing a GCT return and a revocation of the election is made by filing a BCT return.

During 1984, the Taxpayer, reported its income taxes on the basis that it was not a banking corporation under Code section 11-640(a)(9) and, as a result, filed a GCT return. The Taxpayer made the election in the Grandfather Provision on or before the due date for filing its return for its taxable year ending during 1985 by filing a GCT return for that year. It has continued to file GCT returns since that time.

Currently, the Taxpayer is a wholly owned subsidiary of the Commercial Bank and the Commercial Bank is a wholly owned subsidiary of Holding Company. The Commercial Bank and Holding Company, both corporations, file a consolidated federal income tax return.

You have presented three scenarios concerning the Taxpayer and have asked us to rule whether the Taxpayer's election to be taxed under the GCT would be affected by any of those scenarios.

Scenario 1.

Under scenario 1, one or more corporations with which the Commercial Bank files a consolidated federal income tax return will merge into the Taxpayer under section 907 of the BCL. The Taxpayer will be the surviving corporation following the merger.

Merger under the BCL. The Taxpayer proposes to merge with one or more corporations under BCL section 907. BCL section 907 authorizes one or more foreign corporations and one or more domestic corporations to merge or consolidate. BCL section 907(h) provides that if the surviving corporation is a

corporation the effect of the merger will be same as in the case of domestic corporations under BCL section 906. In this case the Taxpayer, a corporation, will be the surviving corporation.

BCL section 906(b)(1) provides that after a merger the surviving corporation will "possess all the rights, privileges, immunities, powers and purposes of each of the constituent corporations." BCL section 906(b)(3) provides that the surviving corporation "will assume and be liable for all the liabilities, obligations and penalties of each of the constituent corporations."

Thus, under the BCL when two or more corporations merge, one survives as a corporate entity. Those BCL provisions reflect earlier judicial recognition that the distinction between a merger and a consolidation is that in a consolidation a new corporation results from the consolidation of the corporations and in a merger one of the corporations continues. See, e.g., Matter of Bergdorf, 149 A.D. 529 (N.Y. App. Div.), aff'd, 206 N.Y. 309 (1912).

Grandfather provisions and corporate reorganizations. The effect of corporate reorganizations on grandfather provisions has been addressed in other contexts, and requires an analysis of the language of the provision interpreted consistent with the applicable corporate law. For example, in the Matter of the First Sterling Corporation v. Lundy, 14 A.D.2d 193 (N.Y. App. Div. 1961), aff'd, 11 N.Y.2d 836 (1962), a subsidiary owned a building that was entitled to conjunctional billing under a tariff of Con Edison in effect in 1959. In 1960, the subsidiary consolidated with its parent into the petitioner. At that time conjunctional billing was available only to customers who had taken service in 1959. The petitioner sought to continue the subsidiary's conjunctional billing, relying on the sections in Stock Corporation Law (substantially the same as BCL section 906) providing that a consolidated corporation succeeds to the rights and privileges of each of the constituent corporations.

The Appellate Division reasoned that the issue was not resolved by the succession of legal rights, but a "problem of identity." The Con Edison tariff was available only to a "customer who" was "taking service" on a particular date. The customer in this case was the subsidiary. The petitioner, a

different corporation than resulted from the consolidation, was not the "customer" entitled to conjunctional billing under the tariff. Thus, although the petitioner had succeeded to the right to conjunctional billing under the relevant corporate statute, it did not qualify under the terms of the tariff. See also Alabama Power Company v. Tennessee Valley Authority, 948 F.Supp. 1010 (N.D.Ala. 1996) (Grandfather provision in Tennessee Valley Authority Act did not apply to an affiliated corporation because it was a different entity.)

In Texaco Refining and Marketing, Inc. v. Delaware River Basin, 824 F.Supp. 500 (D.Del. 1993), aff'd, 30 F. 2d (3rd Cir. 1994), a grandfather provision in a 1961 compact concerning the Delaware River Basin that granted a certificate of entitlement to corporations that could lawfully draw water from the basin in 1961. The grandfather provision permitted the certificates to be transferred in a statutory merger. Two of the certificate holders entered into similar two-step transactions: first, a another corporation acquired the stock of the holder; second, the parent merged another subsidiary into the holder with the holder being the surviving corporation. The result was that, in each case, the corporate holder of the certificate survived as a subsidiary of a another corporation.

The Delaware River Basin Commission ("DRBC") held that the corporate holders could no longer draw water under the certificate because they were no longer under the same ownership and control. The corporate holders brought an action in federal district court to overturn the decision. The court agreed with the holders, reasoning that the rights under the grandfather provision applied to the corporation as an entity and not to its stockholders. Because in both cases, the same corporation continued to hold the certificate, it was entitled to continue to draw water.

In conclusion, the court stated that it:

> is mindful of the potential evils of permanent exemptions under the `grandfather clause.' Absent an express mandate from the sovereign legislatures, however, the DRBC remains constrained by the language of the charging instrument as interpreted consistent with accepted principles of corporate law.

The proposed merger under scenario 1. The Grandfather Provision permits an election to be made by a "corporation described in paragraph three of this subdivision which was subject to [the GCT] during [1984]." It also provides that "such election shall continue to be in effect until revoked by the taxpayer." By its terms, the provision applies to a "corporation." A corporation makes the election to be taxed under the GCT, and the election continues until the corporation revokes it by filing a BCT return. Code § 11-640(d); 19 RCNY § 3-01(b), definition of Banking Corporation, ¶ (x)(B).

In a merger under the BCL, one corporation survives, and it is identified in the plan of merger. In this case, the Taxpayer will be designated as the surviving corporation. Its certificate of incorporation will be automatically amended to reflect any necessary changes in the plan of merger (BCL section 906(b)(1)), and it will possess all the rights and assume all the liabilities of it and the merged corporations. BCL §§ 906(b)(3) and (4).

Under the BCL, the Taxpayer will continue to exist following the merger. Unlike First Sterling and Alabama Power, no problem concerning identity arises, because the Taxpayer is the entity that made the election under the Grandfather Provision. Like Texaco Refining and Mining, in the merger as you propose it, the surviving entity will be the entity covered by the Grandfather Provision.

The language of the Grandfather Provision provides that a corporation's election continues until the corporation revokes it. No authority suggests that when a corporation is the surviving corporation in a merger under the BCL it has revoked its election. Had the legislature intended that an election apply only when a taxpayer continued in the same business or with the same assets it could have so provided in the statute.

Based on the facts presented and representations submitted, we have determined that the merger you propose under scenario 1 will not affect the Taxpayer's election under Code section 11-640(d) to be taxed under the GCT.

Scenario 2.

Under scenario 2, the Taxpayer will be transferred to Holding Company or to a subsidiary of Holding Company with which Holding Company files a consolidated federal income tax return. Following that transfer, one or more corporations with which the Commercial Bank and the Holding Company files a consolidated federal income tax return will merge into Taxpayer. The Taxpayer will be the surviving corporation following the merger.

Scenario 2 involves two steps: first, the Taxpayer's stock will be transferred from the Commercial Bank to Holding Company or to a subsidiary of Holding Company; second, one or more companies will be merged into the Taxpayer, with the Taxpayer as the surviving corporation.

Transfer of the Taxpayer's stock. As discussed above, the Grandfather Provision provides that an election made under its provisions is in effect until revoked by the electing corporation. RCNY section 3-01(b)(x)(B) provides that a revocation is made by filing a BCT return, and no authority suggests that a change of ownership of the stock of an electing corporation constitutes such a revocation. In addition, absent specific authority to the contrary, a change in the ownership of a corporation's stock does not generally affect the corporation's rights and liabilities with respect to other entities. Had the legislature intended that an election under the Grandfather Provision no longer apply following a change in the ownership of a taxpayer's stock, it could have so provided in the statute.

As a result, we conclude that if, as provided for in scenario 2, the Taxpayer will be transferred to Holding Company or to a subsidiary of Holding Company with which Holding Company files a consolidated federal income tax return, that transfer will not affect the taxpayer's election under the Grandfather Provision.

Merger. In the discussion concerning scenario 1, above, we concluded that the merger you proposed would not affected the Taxpayer's election under the Grandfather Clause. We reach the same conclusion with respect to the merger proposed as part of scenario 2.

As a result, we conclude that the Taxpayer's election under the Grandfather Clause would not be affected by the events you propose as scenario 2.

Scenario 3.

Scenario 3 follows either scenario 1 or 2. At that point, certain business activities currently conducted by subsidiaries of the Commercial Bank or Holding Company will be transferred to the Taxpayer.

Under scenario 3, certain business activities of the Taxpayer currently conducted by other corporations will be transferred to the Taxpayer. Based on the facts presented and representations submitted, we conclude that the transfer of certain business activities to the Taxpayer will not affect the Taxpayer's election under the Grandfather Provision. The Grandfather Provision does not indicate that the proposed expansion of business you have described constitutes a revocation of an election made under its provisions.

* * *

The Department of Finance reserves the right to verify the information submitted.

Very truly yours,

Devora B. Cohn
Assistant Commissioner
for Legal Affairs

LED:ld