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Peter L. Faber

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STATE AND LOCAL INCOME AND FRANCHISE TAX ASPECTS OF CORPORATE ACQUISITIONS

Peter L. Faber
PETER L. FABER

Peter L. Faber is a partner in the law firm of McDermott, Will & Emery where he heads the New York tax practice and chairs the firm’s nationwide State and Local Tax Practice Group. He specializes in tax planning and controversy work, including litigation, at the federal, state, and local levels.

His state and local tax practice has included tax planning for corporate acquisitions, divestitures, and restructurings; combined report planning; residence matters; and a variety of other matters. He has litigated many cases before state and local administrative agencies and courts and has represented taxpayers at all levels of the administrative controversy and ruling process. He has also represented companies and industry groups in legislative matters.

Mr. Faber has served as Chairman of the American Bar Association Section of Taxation and is a member of the Section’s Committee on State and Local Taxes. He is a former Chairman of the New York State Bar Association Tax Section. Mr. Faber has served as a member of the Governor’s Council on Fiscal and Economic Priorities and is Chairman of the New York Chamber of Commerce and Industry’s Committee on Taxation and Public Revenue. He serves on the Board of Directors and the Executive Committee of the Chamber of Commerce.

He has served on the Governor’s Temporary Commission to Review the New York Sales and Use Tax Laws and as a member of the New York State Legislature’s Tax Study Commission’s Policy Advisory Group. He currently serves as a member of the New York State Tax Appeals Tribunal’s Advisory Committee, the New York City Tax Appeals Tribunal’s Advisory Committee, the New York State Tax Department’s Taxpayer Advisory Committee, and the New York City Department of Finance Advisory Committees on Business Tax Apportionment and Unincorporated Business Income Tax Reform.

Mr. Faber has lectured on state and local taxation at the Georgetown University Institute on State and Local Taxation, the National Institute on State and Local Taxation, the Interstate Tax Conference, the National Tax Association, The NYU Annual Institute on State and Local Taxation, the National Conference of State Tax Judges, the Multistate Tax Commission, and before many other professional groups. He is a member of the Advisory Committees of the Georgetown and NYU Institutes. He is the author of many articles on state and local taxation.

Mr. Faber graduated from Swarthmore College with high honors and from Harvard Law School, cum laude.
I. Introduction.
A. State and local tax consequences are often ignored, or are addressed too late, in planning corporate acquisitions.
B. Form can be important in determining the state and local tax consequences of an acquisition. In many states, the principle that substance prevails over form is less well developed than it is under federal tax laws.

II. General considerations.
A. Effect of an acquisition on jurisdiction to tax.

1. If a purchasing corporation (P) that is not subject to a state’s taxing jurisdiction buys the assets of a target corporation (T) that is doing business in the state, P will become taxable in the state and the state’s apportionment formula may become applicable to P’s worldwide operations. See, e.g., Reuters Ltd. v. Tax Appeals Tribunal, 180 A.D.2d 270, 584 N.Y.S.2d 932 (3d Dep’t 1992), aff’d, 82 N.Y.2d 112, 603 N.Y.S.2d 795 (1993), cert. denied, 512 U.S. 1235 (1994) (corporation organized in the United Kingdom required to file a New York State corporate franchise tax return reporting its worldwide income).


   a. P.L. 86-272, a federal statute, provides generally that a corporation that is engaged in the business of selling goods cannot be subject to a state net income tax if its only business activities within the state consist of the solicitation of orders that are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from outside the state.
b. If P acquires T's assets and T was protected by P.L. 86-272 from being taxed in a state, that protection can be lost if P's activities in the state go beyond solicitation. This problem can be avoided if P buy's T's stock so that T's operations and P's are not combined in the same corporate entity.

B. Effect of an acquisition on combined and consolidated reporting.

1. States ordinarily require corporations to be engaged in a unitary business for them to be permitted or required to file combined or consolidated reports.

2. The injection of a new member into a vertical corporate chain can fill a gap and create a unitary business where none previously existed.

3. In a particular case, it may be argued (by either the taxpayer or the taxing authorities) that unitary status should begin only after a period of time necessary to integrate the operations of the two corporations. Compare, Appeal of Allied Signal Company, Inc., CCH California State Tax Reporter ¶ 401-798 (S.B.E. 1990) (no immediate unitary business), with Appeal of Atlas Hotels, Inc., CCH California State Tax Reporter ¶ 401-014 (S.B.E. 1985, and Appeal of Paradise Systems, Inc., (Ca. S.B.E. 1997, 1997 Cal. Tax LEXIS 125) (unitary status immediately after acquisition).

C. Effect of an acquisition on apportionment and allocation of income.

1. If P acquires T's assets and business, T's assets and business will become P's and will be taken into account in computing P's apportionment factors.

2. If P buys T's stock and not its assets, T's apportionment factor items (i.e., its property, payroll, and sales) will be trapped in T's corporate entity and will not affect P's as long as the two corporations do not file combined or consolidated reports.

III. Taxable acquisitions.

A. Treatment of the seller.

1. General principles of gain calculation and recognition.

   a. The sale of a business is generally treated as is the sale of any other asset. Gain is recognized unless a specific provision exempts or defers it.
b. Under federal tax law, the sale of a corporate business will be tax-free if the consideration consists substantially of P stock (or stock of P's parent). The technical requirements for tax-free treatment vary depending on the form of the transaction. I.R.C. § 368. Gain will be taxable to the extent of non-stock consideration. I.R.C. §§ 354, 356.

c. Calculation of gain.

(1) The gain on the sale of T’s assets or stock is often the same for state and local purposes as it is for federal purposes. Many jurisdictions have no special basis rules and the federal gain is automatically incorporated into the tax base.

(2) Some states have different depreciation rules than the federal rules, sometimes reflecting a conscious decision not to adopt the tax subsidy inherent in the federal accelerated depreciation system. See, e.g., Cal. Rev. and Tax Code § 24349. Typically, these states adjust gain or loss on sale to reflect the different depreciation rules. See, e.g., Tenn. Code Ann. § 67-4-805(2)(B); Kan. Stat. Ann. §§ 79-32,117(c)(iii) and 79-32,138(c)(i); Wis. Stat. § 71.26(2)(a).

(3) Another area of possibly nonconforming basis involves the filing of consolidated and combined returns by related corporations.

(a) Corporations linked by 80% or more common ownership with a corporation at the top of the chain may, but cannot be required to, file consolidated federal returns. The typical pattern in the states is for consolidated or combined returns to be allowed only if, in addition to common ownership, the corporations are engaged in a unitary business. Moreover, corporations that are linked by common ownership and that are engaged in a unitary business can be compelled to file combined or consolidated returns against their will. Thus, often corporations that file consolidated federal returns file separate state returns, and vice versa.

(b) Under federal regulations, the basis of a parent in
a subsidiary’s stock when the corporations file consolidated returns is adjusted for a variety of factors, including the subsidiary’s income and loss, distributions, and other items. Regs. § 1.1502-32. The states typically do not have special basis adjustment rules nor do they change federal basis to reflect differences between federal and state filing status. Thus, discontinuities can arise when corporations file consolidated returns in one jurisdiction and separate returns in another and federal basis adjustments (or the lack thereof) are automatically reflected in state basis.

(i) Taxpayers in particular situations may urge the taxing authorities in their states to exercise discretionary powers to adjust basis to reflect the state filing method. See Walsh v. State of New Jersey, Department of the Treasury, Division of Taxation, 10 N.J. Tax 447 (N.J. Tax Ct. 1989), aff’d per curiam, 240 N.J. Super. 42 (App. Div. 1990) (shareholders of S corporation not required to use federal basis on sale of their stock where state did not recognize subchapter S and federal basis adjustments would produce an “anomalous result”); The Bank of Baltimore v. State Department of Assessments and Taxation, Maryland Tax Court (1995), CCH Maryland State Tax Reporter ¶ 201-518 (recapture of federal bad debt reserve not taxable by Maryland when bank had not used bad debt reserve method for Maryland tax purposes).

(ii) Taxpayer filing California combined returns on a worldwide unitary basis was not allowed to increase the basis of a subsidiary’s stock by the subsidiary’s undistributed earnings and profits. California had not adopted a statute or regulations comparable to the federal investment adjustment regulations and statute allowing adjustments for items “properly chargeable to capital account”
was inapplicable. Appeal of Rapid-American Corporation (SBE 1996), CCH California State Tax Reporter ¶ 402-893, replaced by new opinion (SBE 1997), CCH California State Tax Reporter ¶ 402-934.

(iii) Massachusetts conforms strictly to federal law. Thus, a distribution to a parent corporation that did not result in federal tax because it was a "deferred intercompany transaction" under the federal consolidated return regulations did not result in Massachusetts tax even though the parent and subsidiary did not file combined Massachusetts returns. R.J. Reynolds Tobacco Co. v. Commissioner of Revenue (Appellate Tax Board 1997), CCH Massachusetts State Tax Reporter ¶ 440-326.

(iv) Taxpayers may be able to bring about appropriate basis adjustments by engaging in actual intercorporate transactions that mirror the transactions that are deemed to occur for state tax purposes.

2. Sale of subsidiary stock.


(1) The sale of stock of a subsidiary is ordinarily taxable as is the sale of any other asset.

(2) The parent’s gain or loss is ordinarily capital.

(3) The basis of the subsidiary’s assets does not change unless a special election is made. I.R.C. § 338.

b. State taxation of gain or loss.

(1) Ordinarily, gain from the sale of a subsidiary’s stock is taxable, mirroring the federal treatment.

(2) Some states exempt, in whole or in part gain from the sale of a subsidiary’s stock. See, e.g., N.Y. Tax Law
§ 208.9(a)(1).

(3) The use of an intermediate holding company in another state may not divert gain from the parent. See, e.g., Trans-Lux Corp. v. Meehan, 43 Conn. Sup. 314, 652 A.2d 539 (Ct. Super. Ct. 1993), CCH Connecticut State Tax Reporter ¶ 400-056, in which an intermediate holding company’s gain on the sale of its subsidiaries’ stock was allocated to its parent in order clearly to reflect income despite uncontroverted evidence that the holding company was formed and held the subsidiaries’ stock for non-tax business purposes.

c. Apportionment or allocation of gain.

(1) The characterization of the parent’s gain or loss as business or nonbusiness income can be important. Business income is typically apportioned among the states in which the taxpayer does business, usually based on the relative amounts of the taxpayer’s property, payroll, and sales in each state. Nonbusiness income is usually allocated entirely to the state of the taxpayer’s commercial domicile.

(2) The Uniform Division of Income for Tax Purposes Act (UDITPA) defines business income to include income from intangible property (presumably including gains from the sale of subsidiary stock) “if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.” UDITPA § 1(a).

(3) The Supreme Court has held that income from a subsidiary that is not engaged in a unitary business with the parent cannot constitutionally be treated as business income subject to apportionment under the Due Process Clause. ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982); F.W. Woolworth Co. v Taxation and Revenue Department, 458 U.S. 354 (1982). The Court reaffirmed this principle, after specifically requesting argument on the point, in Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768 (1992).

(4) The Supreme Court in Allied-Signal did, however, state that income from the sale of stock could be treated as
business income if it served an "operational" rather than an investment function. Income from the sale of stock of a 20%-owned corporation was business income under this exception where the seller acquired and later sold stock of a corporation that did contract manufacturing for it in a new market area. CTS Keene, Inc. (SBE 1993), CCH California State Tax Reporter ¶ 402-589, petition for rehearing denied, June 23, 1993. Similarly, stock of a 50%-owned corporation was an operational asset where the taxpayer provided services to the corporation and purchased goods from it. Hercules, Inc. v. Comptroller of the Treasury, Maryland Tax Court (1995), CCH Maryland State Tax Reporter ¶ 201-521, aff'd, Maryland Court of Special Appeals (1997), CCH Maryland State Tax Reporter ¶ 201-551; Hercules, Inc. v. Commissioner of Revenue, ___ Mn. ____ (1998), CCH Minnesota State Tax Reporter ¶ 202-792, rev'g decision of Minnesota Tax Court, CCH Minnesota State Tax Reporter ¶ 202-716 (1997).

d. Basis of target assets.

(1) Ordinarily, the basis of T's assets does not change when its stock is sold.

(2) Under federal law, an election to change the basis of T's assets to reflect the purchase price of its stock is available under certain circumstances. I.R.C. § 338.

(a) General requirements of section 338.

(i) The buyer must be a corporation.

(ii) P must acquire at least 80% of T's stock.

(iii) The acquisition of T's stock must be in a taxable transaction.

(b) The general pattern of a section 338 transaction is that T is treated as if it sold its assets to itself. The assets get a new basis but T must recognize gain. Since the T shareholders also recognize gain on the sale of their stock, the double tax generally makes section 338 unattractive unless T has net operating losses that can shelter the gain.
(c) If T is a subsidiary of another corporation or is an S corporation, section 338(h)(10) of the Code offers a viable alternative.

(i) If both P and T's parent (or shareholders, if T is an S corporation) elect, the transaction is treated as if T sold its assets in a taxable transaction and liquidated into its parent tax-free under section 332 of the Code. The sale of T stock by its parent is ignored for tax purposes.

(ii) Under section 338(h)(10), only a single tax is imposed, on the deemed sale by T of its assets.

(d) The states have taken different approaches to section 338(h)(10).

(i) In New York, T must file two reports: one for the short year ending with and including the day on which the deemed sale occurs, and one for the rest of the year. The gain is included in the selling parent's combined report with T if combined reports are filed. The sale of T stock by the parent is not ignored, but it is ordinarily not taxed because gains from the sale of subsidiary stock are not taxable in New York. TSB-M-91 (4)(C) (April 17, 1991); Regs. §§ 3-2.2, 6-2.7, 18-2.2, 21-2.7. New York City takes the same position. Ruling No. X-2-006-001 (September 24, 1990). If T is an S corporation, however, New York follows the federal characterization of a section 338(h)(10) transaction and the sale of T stock by its shareholders is ignored. Advisory Opinion TSB-A-97(2)I.

(ii) California allows the corporations to elect section 338(h)(10) treatment or not, regardless of whether they have elected section 338(h)(10) treatment for federal purposes. Cal. Rev. and Tax. Code §
FTB Chief Counsel Ruling CI-88-254 (November 15, 1988).
The choice may depend on the relative bases of T in its assets and of T's parent in T's stock and whether it would be preferable to have the gain treated as business or nonbusiness income.

(iii) Some states automatically accept the section 338(h)(10) election if it is made for federal purposes. See, e.g., Ga. Code § 48-7-21(b)(7); Michigan, Revenue Administrative Bulletin 1994-12, CCH Michigan State Tax Reporter ¶ 319-253; Virginia, Ruling of Commissioner P.D. 91-317 (1991), reported at CCH Virginia State Tax Reporter ¶ 202-115; West Virginia Department of Taxation and Revenue, Technical Assistance Advisory 95-003; Illinois Private Letter Rulings 89-0306 and 89-0222.

section 338 election because of the unavailability of section 338(h)(10) rejected).


(e) Even if a state purports to recognize section 338(h)(10), if it does not allow the selling parent and T to file combined reports the tax liability with respect to the deemed sale will be T’s and the burden will pass to P unless the parent agrees by contract to assume it. See Illinois Dep’t of Revenue Letter Ruling IT-89-306 (1989), CCH Illinois State Tax Reporter ¶ 11-101.40. This is particularly a problem in states such as New Jersey and Maryland that do not permit combined reports under any circumstances.

(3) Significance of basis for state and local purposes.

(a) Calculation of gain on later sale of assets.

(b) Depreciation.

(c) Apportionment of income if property factor is based on income tax basis.

3. Sale of T stock by individual shareholders.

a. Selling T shareholders are generally taxed on any gain by their state of residence.

b. Shareholders contemplating a sale of their stock may move to a state with lower tax rates before the sale. A change in domicile must be genuine to be respected for tax purposes and there is a strong presumption against a change of domicile. See, e.g., N.Y. Tax Law § 689(e). In the Matter of Newcomb, 192 N.Y. 238 (1908).
c. Selling stock in an installment sale and then moving to a low-tax state will ordinarily not shift the incidence of taxation. *Appeal of Gordon* (SBE 1983), CCH California State Tax Reporter ¶ 400-631; N.Y. Tax Law § 639 (gain accelerated into last resident return).

4. Sale of assets by T.
   
      
      (1) T is taxed on any gain and can deduct any loss.
      
      (2) If T is liquidated and T is not a subsidiary of another corporation, T’s shareholders are taxed on any gain on the liquidation. I.R.C. § 331. Thus, the same economic gain can be subject to a double tax. If T is a subsidiary of another corporation, T’s shareholder is not taxed on the liquidation. I.R.C. § 332.
      
      (3) The shareholder-level gain can be deferred if T is not liquidated and is kept in existence as a holding company that invests the sale proceeds.
   
b. Recognition of gain or loss.
      
      (1) The recognition of gain or loss for state and local purposes will generally conform to the recognition of gain or loss for federal purposes.
      
      (2) If an asset has a different basis for state and local purposes than it does for federal purposes, the amount of gain may differ and some states require that the federal gain or loss be modified to reflect the difference. See, e.g., Wis. Stat. § 71.26(2)(a).
   
c. Allocation of sale price among assets.
      
      (1) Allocation of the sale price among different assets can affect the nature of the gain as business or nonbusiness and, hence, can affect each state’s share of the gain.
      
      (a) Gains that are treated as business income are apportioned under the normal apportionment methods. UDITPA §§ 1(a) and 9.
      
      (b) Gains and losses from the sale of nonbusiness
property are allocated based on the nature of the property. UDITPA § 6.

(i) Gains and losses from the sale of real property are ordinarily allocated to the state in which the property is located.

(ii) Gains and losses from the sale of tangible personal property are ordinarily allocated to the state in which the property is located or, if the corporation is not taxable in that state, to the state of the taxpayer’s commercial domicile.

(iii) Gains and losses from the sale of intangible property are ordinarily allocated to the state of the taxpayer’s commercial domicile.

(2) The allocation of the sale price for federal tax purposes is subject to the requirements of section 1060 of the Internal Revenue Code.

(a) In general, section 1060 requires the price to be allocated to different classes of assets to the extent of the fair market value of the assets falling within each class. Any excess price is allocated to goodwill.

(b) Section 1060 applies only if the assets sold comprise a business.

(c) The parties are required to report certain information about the allocation to the Internal Revenue Service.

d. Characterization of income.

(1) The states generally apply two tests (or variations) in determining whether gain on the sale of a corporation’s assets is business income or nonbusiness income: the transactional test and the functional test. See Faber, “When does the Sale of Corporate Assets Produce Business Income for State Corporate Franchise Tax Purposes,” The Tax Executive (May/June 1995).
(2) The Uniform Division of Income for Tax Purposes Act (UDITPA) defines "business income" as:

"Income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." § 1(a).

(3) The transactional test.

(a) Gain is treated as business income if the taxpayer regularly engages in the type of transaction producing the gain.


(c) Factors considered in applying the transactional test.

(i) Whether sale of the property was the taxpayer's principal business activity. McVean & Barlow, Inc. v. New Mexico Bureau of Revenue, supra.

(ii) Whether sales of similar property were common, even if not the taxpayer's normal business activity. Atlantic Richfield


(iv) Whether sale proceeds are distributed in liquidation and not reinvested in the business. Union Carbide Corporation v. Huddleston, supra.

(v) Whether the sale was prompted by extraordinary circumstances. Phillips Petroleum Company v. Iowa Department of Revenue and Finance, 511 N.W.2d 608 (Ia. 1993); Union Carbide Corporation v. Huddleston, supra (sales incurred to raise money to pay massive tort liabilities and to buy back stock to resist hostile takeover attempt); Kroger Co., Kan. Board of Tax Appeals 1997, CCH Kansas State Tax Reporter ¶ 200-746 (sale of leasehold interests as part of the discontinuance of a business pursuant to a restructuring).

(vi) Size of the transaction. Phillips Petroleum Company v. Iowa Department of Revenue and Finance, supra.

(4) The functional test.
(a) Gain is treated as business income if the assets were used to generate business income, even if their sale is not a regular incident of the business.

(b) The Multistate Tax Commission regulations incorporate a strong presumption in favor of business income. The general definition of business and nonbusiness income provides:

"[A]ll income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of Article IV, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income. . . . In general all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or a business." § IV.1.(a).

The regulation specifically dealing with gain from the sale of property clearly adopts the functional test:

"Gain or loss from the sale, exchange or other disposition of real or tangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business." § IV.1.(c)(2).

(c) The theory of the functional test is that the second clause of the UDITPA definition contains a separate and independent test. States adopting this interpretation hold that income will be business income if it meets either the transactional or the functional test.

(d) Under this approach, gain from the sale of the

(e) Gain from the sale of a pipeline that had been idle for three years and was no longer producing income was held to be nonbusiness income in a narrow application of the test. *Laurel Pipe Line Company v. Commonwealth of Pennsylvania*, 537 Pa. 205, 642 A.2d 472 (1994). (In a statement of policy adopted on November 12, 1994, the Pennsylvania tax authorities said that they would interpret *Laurel Pipe* narrowly. For example, the Department said that it viewed the case as being limited to situations in which the sale proceeds were distributed to shareholders and were not reinvested in the business. CCH Pennsylvania
But, see, MTC Regs. § IV.1.(c), Ex. (iii) (business income when property was put up for sale when business use ended and sold 18 months later).

The functional test has been applied to a sale of a subsidiary's stock. Indiana Department of Revenue Admin. Decision 94-0709 ITC (1996) (sale by gasoline station owner of stock of gasoline producer from which it purchased gasoline).

Is the functional test a valid interpretation of the statute?

Yes.

The UDITPA language is based on prior California case law.

The California cases held that income from property the acquisition, management, and disposition of which was an integral part of the taxpayer's business was business income. Houghton Mifflin Co. (SBOE 1946); International Business Machines Corp. (SBOE 1954); National Cylinder Gas Co. (SBOE 1957).

Applying this test, several cases held that the fact that property was used in the business was sufficient to make gain on its sale business income. See, e.g., American Airlines, Inc. (SBOE 1952) (sale of aircraft); American President Lines, Inc. (SBOE 1961) (sale of charter boat);
Velsicol Chemical Corp.
(SBOE 1961) (sale of patents, specifically referring to the “acquisition, management, and disposition” standard); Voit Rubber Corp. (SBOE 1964) (sale of all of the assets of a business).

(B) Later cases have cited this background in holding that UDITPA incorporates the functional test. See e.g., Borden, Inc. (CA SBOE 1977); Appeal of Chief Industries, Inc., 255 Kan. 640, 875 P.2d 278 (1994) (dissent).

(ii) No.

(A) The argument against the functional test is based on a literal reading of the statutory language.

(I) The use of the word “and” before the word “disposition” indicates that the disposition of the property and not just its use must be an integral part of the taxpayer’s business.

(II) See the analysis of the court in General Care Corporation v. Olsen, 705 S.W.2d 642 (Tenn. 1986); The Kroger Co. v. Department of Revenue (Cir. Ct. Cook County, Ill. 1995), CCH Illinois State Tax Reporter ¶400-716. See, also, Western Natural Gas Co. v. McDonald, supra; McVean & Barlow, Inc. v. New Mexico Bureau

(B) Opponents of the functional test concede the presence of the legislative history in California and often concede that the functional test is appropriate from a tax policy standpoint, but they argue that these considerations must yield to the clear language of the statute. See Uniroyal Tire Company, Inc. v. State of Alabama Department of Revenue, CCH Alabama State Tax Reporter ¶ 200-645 (Admin. Law Div. 1997) (functional test supported by tax policy but not by statutory language, citing Faber, supra, at III.A.4.d(1)), rev'd, Montgomery County Circuit Court (1998).

(h) Some states have adopted statutory language that clearly incorporates the functional test (by replacing the word “and” before “disposition” with the word “or”). See, e.g., Id. Code § 63-3027(a)(1); Tenn. Code Ann. §67-4-804(a)(1); N.C. Gen. Stats. § 105-130.4(a)(1) (“and/or” before “disposition”); Kans. Stat. Ann § 79-3271(a) (taxpayer may elect the application of the functional test); Ia. Code § 422.32.2 (business income includes gain from the sale of property that is “operationally related” to the taxpayer’s business).

(i) Some states have attempted to avoid the controversy by repealing the UDITPA definition. See, e.g., Minn. Stat. § 290.17 (only income “unconnected with” instate business may be allocated and not apportioned).

e. Gain from the sale of out-of-state real property may be separately accounted for if including it in the apportionment formula would
f. Liquidation of T.

(1) If T distributes assets in kind to its shareholders, it will be treated as if it sold them to its shareholders for their fair market values. Gain (and perhaps loss) will be recognized unless T is an 80% or more subsidiary of another corporation. I.R.C. §§ 336, 337.

(2) T's gain on the distribution of appreciated assets will ordinarily be treated as business or nonbusiness income under whichever of the functional or the transactional test as is normally applied in the taxing state.

(3) If a T shareholder receiving a distribution in liquidation of T is a corporation, its gain or loss will be classified as business or nonbusiness as if it had sold its T stock.

g. If T's assets are sold in an installment sale with the price (and gain) being spread over a period of years, a question arises as to what year's apportionment factors are used in apportioning business gain. See Tenneco West, Inc. v. Franchise Tax Board, 234 Cal. App. 3d 1510 (1991) (factors for the year of the sale are used, rather than for the year in which payment is received, on the theory that this more accurately reflects the activities that produced the income).

B. Treatment of the buyer.

1. Basis of purchased assets.

a. Allocation of purchase price.

(1) P will generally want to allocate as much of the price as possible to assets that produce an early tax benefit (e.g., inventory, short-lived depreciable property).
(2) If T has separate businesses that are not part of a unitary business, P will want to allocate as much of the price as possible to depreciable assets of the business that is conducted in high-tax states.

(3) The allocation of purchase price can affect the property factor of the apportionment formula.

(4) See III.A.4.c.(2) for a discussion of allocation principles.

b. Election to adjust the basis of T’s assets when P buys T’s stock.

(1) For a discussion of the requirements for P to make a section 338 election, see III.A.2.d.

(2) The states generally respect an election to adjust basis under section 338. This is true even for states that, in taxing the seller side of the transaction, do not conform to the federal treatment of a section 338(h)(10) election.

(3) The allocation of basis under section 338 generally is similar to the allocation of basis in an asset purchase under I.R.C. section 1060.

2. Purchase of intangible assets.

a. The buyer should consider forming a separate subsidiary (“passive holding company,” or “PHC”) to purchase T’s intangible assets and license them to the operating corporations that will use them. A separate purchase of the T intangibles by an unrelated buyer is more likely to withstand scrutiny than is a sale-licenseback after the acquisition.

b. If the corporation’s operations are conducted in a jurisdiction that does not impose tax on income from owning intangible assets (such as Delaware or Nevada) or in a state that would effectively tax the corporation’s income through unitary combined reporting, significant state and local tax savings can result. The operating companies can deduct royalties paid to the PHC in the states in which they do business to the extent that those states do not require unitary combined reporting.

c. A PHC should have substance to be respected for business and tax purposes. See, Faber, “Planning for the Use of Intangibles Holding Companies,” State Tax Notes (June 15, 1998).
d. Establishing a PHC.

(1) Preliminary steps.

(a) Consult with intellectual property counsel about protecting intangible assets.

(b) Retain counsel in proposed domicile of PHC.

(c) Retain accounting firm in proposed domicile of PHC.

(d) Determine royalty rate for intangibles. Obtain an appraisal.

(e) Determine necessary steps to protect intangibles in other countries.

(2) Legal documentation.

(a) Form PHC.

(b) Prepare initial corporate papers (bylaws, minutes, etc.).

(c) Draft license agreement between PHC and operating companies.

(d) Draft employment agreements for PHC employees.

(e) Draft form notes for intercompany loans. Charge arm’s length interest.

(3) Organizational steps.

(a) Appoint Board of Directors (majority of outside directors is recommended).

(b) Appoint officers (some from outside).

(c) Hire employee(s) in PHC domicile.

(d) Rent office space in PHC domicile.

(e) Open bank account(s) in PHC domicile.
(f) Open brokerage account in PHC domicile if PHC is to invest in stocks.

(g) Obtain telephone service in name of PHC. Arrange for listing of PHC in telephone directory.

(h) Obtain stationery for PHC.

(4) Operations.

(a) Board of Directors should meet regularly in PHC domicile.

(b) Board should receive regular reports from intellectual property counsel.

(c) Investment policy should be determined at Board meetings.

(d) Royalty rate should be reviewed periodically.

e. Tax authorities in the states in which the operating companies do business may attack the arrangement, particularly if the PHC does not have substance and does not deal with the operating companies on arms-length terms. Theories that they could use include the following:


(3) The PHC is doing business in the taxing state because certain functions are performed there. These may be done by its own employees or by operating company employees. _Lawrence Industries, Inc. v. Sharp_, 890 S.W. 2d 886 (Tex. App. 1994), _cert. denied_, ___ U.S. ___, 116 S. Ct. 708 (1996).
4. The PHC is a mere agent of the operating company and its income should be taxed directly to the operating company. See, e.g., *U.S. Trust Corporation*, N.Y.C. Tax Appeals Tribunal, Administrative Law Judge Division (1995), CCH New York State Tax Reporter ¶ 600-225 (functions of subsidiary performed by parent’s employees in New York).

5. The companies should be required to file combined reports. *Rulings of Virginia Commissioner of Taxation* P.D. 95-86 (1995), CCH Virginia State Tax Reporter ¶ 202-709 (PHC was a mere shell, royalties charged to taxpayer were not arms-length), and P.D. 95-229 (1995), CCH Virginia State Tax Reporter ¶ 202-729 (no proof of reasonableness of royalties, PHC lacked substance).

f. Cases in which PHCs have been upheld.


2. *Ruling of Virginia Commissioner of Taxation* P.D. 94-309 (1994), CCH Virginia State Tax Reporter ¶ 202-528 (PHC’s officers and directors were independent of taxpayer, royalties charged to taxpayer were reasonable).

3. Deduction of interest.

a. Interest is generally deductible by corporations.

b. Express limits on deduction of interest.

1. Federal limits.

(a) Under I.R.C. § 279, interest in excess of $5,000,000 is not deductible if it is incurred to acquire another corporation, the debt has certain equity-type features, and the borrower is highly-leveraged.

(b) Under I.R.C. § 163(e)(5), original issue discount on certain high yield obligations is not deductible and, to some extent, may be treated as equity.
(c) Under I.R.C. § 163(j), interest paid to tax-exempt or nontaxable related parties (e.g., a foreign parent that is subject to a reduced tax on interest income under a tax treaty) by certain highly-leveraged taxpayers is not deductible.

(2) New York limits the deduction of interest when a corporate acquisition is made by a corporation whose leverage is significantly increased, even if the acquisition itself is not financed by debt. See Faber, “New York State Antitakeover Bill: First Step Down a Rocky Road,” Tax Notes (June 5, 1989). N.Y. Tax Law § 208.9(b)(6-a).

c. Limitations on deducting interest attributable to subsidiaries.

(1) States such as New York that exempt from tax dividends and interest received from subsidiaries generally provide that interest incurred to buy a subsidiary’s stock cannot be deducted. See N.Y. Tax Law § 208.9(b)(6). Petition of Supply Resources, Inc., TSB-H-81(31)C, CCH New York State Tax Reporter ¶ 250-238 (1981).


(a) Some of these states do not expressly disallow expenses relating to subsidiary stock, presumably indicating that they are deductible. See, e.g., the Laws of Alabama, Arkansas, New Jersey and Virginia. In Tennessee, an attempt by the tax authorities to disallow expenses relating to tax-exempt dividends from subsidiaries was rejected because of the lack of statutory authority for such a position. Kellogg Co. v. Olsen, 675 S.W.2d 707
(Tenn. 1984); see, also, Director of Revenue v. First Federal Savings & Loan Association of New Castle County, Delaware Superior Court (1972), cited at CCH Multistate Corporate Income Tax Guide ¶ 338.46.

(b) Other states expressly disallow expenses relating to the production of tax-free income, including exempt dividends from subsidiaries. See, e.g., Ky. Rev. Stat. § 141.010(13)(d); Wis. Stat. §§ 71.26(2)(a) and 71.26(3)(l). If a corporation does not borrow expressly for the purpose of buying a subsidiary’s stock but has loans outstanding at a time that it makes an acquisition for cash, the tax authorities may allocate part of its debt to the acquisition on the theory that the debt should be allocated among all of its assets. See, e.g., Kentucky Revenue Policy 41P150, cited at CCH Kentucky State Tax Reporter ¶ 16-024. This can present a major problem for holding companies.

d. Interest deductions will be disallowed if the debt is reclassified as equity.

IV. Tax-free reorganizations.

A. Under federal law, the acquisition of a corporate business can be made on a tax-free basis if the consideration largely consists of stock of the buyer or its parent. The technical requirements for tax-free treatment, including the extent to which nonstock consideration is permitted, vary depending on the form of the transaction. I.R.C. § 368.

B. State rules on tax-free reorganizations.

1. The states have generally not tried to define tax-free reorganizations, relying on their general conformity provisions to provide parity. See, e.g., Florida Department of Revenue, Technical Assistance Advisement No. 94(C)1-005, CCH Florida State Tax Reporter ¶ 202-737.


V. Spinoffs.

A. A spinoff that is tax-free under section 355 of the Internal Revenue Code will generally be tax-free for state and local income tax purposes.

B. A spinoff can change the tax profiles of the distributing and the distributed corporations.

1. An analysis should be done before the transaction of what the corporations will look like afterward.

2. Distributing a division to shareholders can remove the distributing corporation from the taxing jurisdiction of states in which the division does business (or create the possibility of avoiding nexus by further adjustments).

3. The corporate readjustment can create new opportunities for filing (or avoiding) combined reports.

C. For a general discussion, see Faber, “State and Local Tax Aspects of Corporate Spinoffs,” State Tax Notes (February 26, 1996), Tax Notes (April 8, 1996).

VI. Net operating loss carryovers.

A. General state rules governing NOLs.

1. Periods of NOL carryforwards and carrybacks.

   a. The federal rules allow NOLs for taxable years starting after August 5, 1997, to be carried back 2 years and forward 20 years. NOLs for earlier years could be carried back 3 years and forward 15 years.

   b. States, such as New York, that incorporate the federal rules automatically under their conformity provisions now have the 2-year carryback and 20-year carryforward periods.

   c. Some states still have the old federal 15-year carryforward and 3-year carryback periods.
See, e.g., D.C. Code § 47-1803.3(a)(14); Haw. Rev. Stats. § 235-7(d); Ill. Rev. Stats. § 2-207; Ia. Code § 422.35.11; Utah Rev. and Tax Code § 59-7-110(2)(b); Id. Code § 63-3022(c)(1).

d. Some states allow the federal carryforward but allow no carryback.

See, e.g., Col. Rev. Stats. §§ 39-22-504(1), (3); Minn. Stats. § 290.095.1(a); N.M. Stats. Ann. § 7-2A-2(I); Oh. Rev. Code § 5733.04(I)(1); Or. Rev. Stats. § 317.476; S.C. Code § 12-6-1130(4); Wis. Stats. § 71.26(4).

e. Some states allow shorter carryforward periods.

10 years (Kans. Stats. Ann. § 79-32,143(a); Mich. Comp. Laws § 208.23b(h)).

5 years (Ark. Code Ann. § 26-51-427(1)(B); Ariz. Rev. Stats. § 43-1123.B; Cal. Rev. and Tax Code §§ 24416(b) and (e) (reduced from 15 years for taxable years starting after 1993); Conn. Gen. Stats. § 12-217(a); N.C. Gen. Stats. § 105-130.8; R.I. Gen. Laws § 44-11-11(b).

2. Amounts of NOL carryforwards and carrybacks.

a. All states have some mechanism for limiting carryforwards and carrybacks to NOLs attributable to the state.

(1) The most common approach is to apply the state’s apportionment formula to taxable income, determined by taking the NOL into account.

See, e.g., Col. Rev. Stats. § 39-22-504(1). Colorado does not allow an NOL to be carried to a year in which a different apportionment method is used from that used in the year in which the loss was sustained. Rev. Stats. § 39-22-504(5). The Department of Revenue will allow a NOL sustained in a two-factor year to be carried forward to any other two-factor year in the carryforward period regardless of the number of intervening years. Letter of September 17, 1988, cited in CCH Colorado Tax Reporter at ¶ 10-440.55.

(2) Some states limit NOL carryforwards to losses actually sustained in the state.
See, e.g., Miss. Regs. § 506.

(3) Some states require the corporation to have been a taxpayer in the state for the year in which the loss was sustained.

See, e.g., Ga. Code § 48-7-21(b)(3); Id. Code § 63-3022(c)(2); Miss. Regs. § 506 (loss must have been reported on a return); Mo. Regs. 12-CSRS § 10-2,165(3); R.I. Gen. Laws § 44-11-11(b); Wis. Stats. § 71.26(4).

b. Some states place a percentage or dollar limit on carryforwards or carrybacks.

(1) California limits carryforwards to 50% of the NOL (except for certain small businesses). Rev. and Tax Code § 24416(b). The New York City Department of Finance unsuccessfully attempted to get a similar provision enacted in 1990.

(2) Some states limit carrybacks or refunds from carrybacks.

See, e.g., Id. Code § 63-3022(c)(1) (maximum of $100,000 from any taxable year); N.Y. Tax Law § 208.9(f)(5) (maximum of $10,000 from any taxable year); Vt. Stats. Ann. § 5888 (refund from carryback cannot exceed $10,000 for any loss year ending before April 30, 1991; 0 for years ending after April 29, 1991, and beginning before 1993; and $5,000 for years beginning in 1993 and 1994).

c. In recent years, some states have restricted the use of net operating loss carryovers in order to raise revenue. See, e.g., Cal. Rev. and Tax Code § 24416.3 (no losses carried into 1991 or 1992); Pa. Tax Reform Code § 401(3)(M) (repeal of use of carryovers for years starting after 1990; NOLs restored beginning in 1995, but only to the extent of $500,000 per year; the constitutionality of the repeal has been upheld, Garofolo, Curtiss, Lambert & MacLean, Inc. v. Commonwealth, 167 Pa. Commw. 672, 648 A.2d 1329 (1994), CCH Pennsylvania State Tax Reporter ¶ 202-581.

B. State rules governing NOLs in acquisitions.

a. Some states allow the transfer of NOLs in the same manner as under § 381 of the Internal Revenue Code.

(1) Some statutes expressly adopt § 381.

See, e.g., Ala. Code § 40-18-35.1(6); Cal. Rev. and Tax Code § 24471; Minn. Stats. § 290.095(3)(d); Wis. Stats. § 71.26(3)(n) (as modified).

(2) Some states adopt § 381 because of a failure to vary from federal law.


b. Some states limit the circumstances in which T’s losses can pass to P.

(1) Continuity of business.

(a) Several states have no provision for the passage of NOLs from one corporation to another in a merger. Litigation in those states has focused on the question of whether the surviving corporation is the same “taxpayer” as the merged corporation. They have often cited federal cases that addressed the same issue under the law that preceded the enactment of section 381. See, e.g., Libson Shops, Inc. v. Koehler, 353 U.S. 382, reh. denied, 354 U.S. 943 (1957), and other cases that generally established the principle that pre-merger losses could be carried over only to offset post-merger income that was generated by the same assets. See, Faber, “State Tax Treatment of Net Operating Loss Carryovers in Corporate Acquisitions,” The Tax Executive (July/August 1996).

(b) In Arizona, there is no statutory provision but case law holds that T’s NOLs can be used after a merger of T into P only to the extent of P’s post-merger income from the old T business that sustained the losses. Oliver’s Laundry & Dry Cleaning Co. v. Arizona State Tax Commission, 19 Ariz. App. 442, 508 P.2d 107 (1973). NOL

(c) In North Carolina, T’s NOLs are destroyed unless surviving P is substantially the same corporation as pre-merger T. The statute provides that pre-merger losses can be used only against post-merger profits produced by the assets that generated the losses. 17 N.C. Admin. Code § 5C.1507. In one case, T’s losses could not be used after a merger of T into P where P after the merger was much larger and had more extensive businesses than T before the merger. Good Will Distributors (Northern), Inc. v. Shaw, 247 N.C. 157, 100 S.E.2d 334 (1957). The Corporate Income and Franchise Tax Division interprets this case restrictively and will allow T’s loss to pass to P in a merger only if P was an empty shell before the merger. Letter of November 9, 1964, cited at CCH North Carolina State Tax Reporter at ¶ 10-320.51. In another case, T’s losses could not be used by P after a merger when T’s old business continued to produce losses. Fieldcrest Mills, Inc. v. Coble, 290 N.C. 586, 227 S.E.2d 562 (1976). On the other hand, a corporation (apparently a new “shell” corporation) into which three corporations were merged was allowed to use the merged corporations’ pre-merger NOLs where one person owned all of the stock of all of the corporations and the survivor continued the businesses of the merged corporations. Benton Woods, Inc. (Tax Rev. Bd. 1993), CCH North Carolina State Tax Reporter ¶ 201-771. The Department of Revenue does not acquiesce. Id. ¶ 201-772. A more generous approach was followed in Bellsouth Telecommunications, Inc. v. N.C. Department of Revenue, 95-CVS-1982 (Mecklenburg County Superior Court 1996), CCH North Carolina State Tax Reporter ¶ 201-912, in which P was allowed to apply T’s pre-merger NOLs against P’s post-merger income even though it failed to show that T’s assets generated a
profit after the merger. The court noted that P had been forced to create T by an FCC ruling; but for this it would have conducted T's operations, and sustained its losses, directly. The North Carolina Court of Appeals reversed, holding that the taxpayer had failed to show a continuity of business, citing Fieldcrest. CCH North Carolina State Tax Reporter ¶ 201-952 (1997).

The Connecticut courts have shown some flexibility.

(i) The general rule is that NOLs of the merged corporation do not survive a merger. Golf Digest/Tennis, Inc. v. Dubno, 203 Conn. 455, 525 A.2d 106 (1987).

(ii) But in Thermatool Corporation v. Department of Revenue Services, 43 Conn. Sup. 260, 651 A.2d 763 (1994), the court held that, although T's NOLs could not be used by P after a merger, they could be used by a new corporation to which P later transferred the old T business and the stock of which it distributed to P's shareholder because there was a continuity of business.

(iii) In Grade A Market Inc. v. Commissioner of Revenue Services, 44 Conn. Sup. 377, 688 A.2d 1364 (1996), CCH Connecticut State Tax Reporter ¶ 400-140, the pre-merger NOLs of two corporations were allowed to be used against the post-merger income of a third corporation into which they were merged when the three corporations were effectively operated as one before the merger, with common employees and functions. It was unclear whether the post-merger income was generated by the same assets that had generated the NOLs.

(iv) The Department of Revenue has applied continuity of business principles in
allowing a parent corporation's NOLs to pass to a newly-organized "shell" subsidiary into which the parent merged where the following factors were present:

(A) the merger was a statutory merger that qualified as a reorganization under I.R.C. § 368(a)(1)(F);

(B) the ownership of the subsidiary after the merger was the same as that of the parent before it;

(C) the primary purpose of the merger was not tax avoidance;

(D) the subsidiary continued the parent's business after the merger;

(E) the parent's old business was operated by the subsidiary as a separate division or its assets were separately accounted for; and

(F) the only income against which the parent's NOLs were applied after the merger was generated by the parent's old business. Ltr. Rul. No. 97-3, CCH Connecticut State Tax Reporter ¶ 360-535.

(v) In Cunningham Group, Inc. v. Commissioner of the Department of Revenue Service (Superior Court, 1997), CCH Connecticut State Tax Reporter ¶ 400-256, NOLs of the merged corporation were allowed to be used against post-merger income of the surviving corporation where the business that generated losses was continued, even though there was no showing that it generated income after the merger.

(e) A Tennessee trial court has upheld the use of pre-merger NOLs against post-merger income of the acquired assets that had generated the losses.
Little Six Corporation v. Johnson (Chancery Court, Davidson County, Tennessee, 1998).

(2) Common ownership.

See, e.g., Ark. Code Ann. § 26-51-427(3), allowing the transfer of T's NOLs if P acquires T's assets but only if T and P had common ownership of at least 80% and only to the extent of P's post-acquisition income from the old T assets. (The statute literally applies to taxable asset purchases. It does not indicate what proportion of T's assets must be acquired by P.)

(3) Ohio law provides that T's NOLs survive a merger into P only if T was an Ohio taxpayer when the losses were sustained. Litton Industrial Products, Inc. v. Limbach, BTA No. 87-G-187 (1990), CCH Ohio State Tax Reporter ¶ 400-506.

2. Curtailment of NOLs because of a change in stock ownership (federal provision: I.R.C. § 382).

a. Some states apply the § 382 limitations in the same manner as
under the Internal Revenue Code.

(1) Some statutes expressly adopt § 382.


(2) Some states adopt § 382 because of a failure to vary from federal law.

See, e.g., California, Delaware, Illinois, Kansas, New York.

b. Some states have no provision comparable to § 382 and reject the concept.

See, e.g., Ruling 93-23 (Connecticut Department of Revenue Services 1993), CCH Connecticut State Tax Reporter ¶ 360-489.

c. Some states have their own rules limiting the use of NOLs when there is a change in stock ownership.

(1) New Jersey.


(b) T’s NOLs are destroyed if:

(i) There is a 50% or more ownership change (Regs. § 18:7-5.14(a) indicates that this refers to cumulative changes since June 30, 1984); and

(ii) The corporation changes the business giving rise to the loss. (Regs. § 18:7-5.13(c) indicates that a change does not occur even if all of the old product lines are replaced by new product lines, the corporation’s name changes, and new employees are hired.)

(c) T’s NOLs are also destroyed if there is a 50% or more ownership change and P’s primary purpose in making the acquisition was to get the benefit of
T's NOLs (similar to I.R.C. § 269).

(d) The New Jersey Division of Taxation holds that T's NOLs cannot be used by P after T merges into P because there is no provision in the statute for a transfer of the NOLs from T to P. Regs. § 18:7-5.13(b). This position was upheld in Richard's Auto City, Inc. v. Director, Division of Taxation, 140 N.J. 523, 659 A.2d 1360 (1995), CCH New Jersey State Tax Reporter ¶400-378, rev'g 270 N.J. Super. 92 (App. Div. 1994).

(2) New York.

(a) If T is taken over (i.e., a shareowner's voting stock holdings climb above 50%) in a highly leveraged acquisition, its NOLs are destroyed. Tax Law §§ 208.9(f) (2-a), (2-b), and (2-c).

(b) This result occurs even if the use of the NOLs would otherwise be limited by I.R.C. § 382.

(c) Definition of "highly leveraged acquisition."

(i) General requirements.

(A) The ratio of T's "average aggregate debt" to its "average aggregate equity" for the taxable year in which the acquisition occurs must exceed that ratio for the immediately preceding taxable year by more than 100%.

(B) The ratio of T's "average aggregate debt" to its "average aggregate assets" for the taxable year in which the acquisition occurs must exceed that ratio for the immediately preceding taxable year by more than 60%.

(C) The total interest paid or accrued by the acquiring person during its taxable year in which the acquisition occurs must exceed
$1,000,000.

(ii) Operating rules.

(A) Assets are valued at accounting (not tax) book value.

(B) The averages are calculated by reference to both the acquiring person and T unless they are both members of the same affiliated group.

(C) If the acquiring person is a member of an affiliated group, all members of the group in the aggregate are treated as the acquiring person.

(iii) Observations.

(A) The law does not indicate what measuring dates are used in computing the averages.

(B) There is no requirement that the transaction itself be financed by debt. As long as the ratios increase, a transaction will be subject to the rules applicable to highly leveraged transactions, even if all of the consideration is the buyer’s stock. The law reaches companies that use debt for the first time, but it will not reach companies that have always been highly leveraged.

(C) The meaning of “equity” is unclear.

3. Use of NOLs in a consolidated or combined return after an acquisition.

a. The states generally do not limit the use of NOLs, although general limitations on the use of out-of-state losses apply.

b. Illinois applies the SRLY concept. Adm. Code Regs. § 100.2230(b). New York apparently does the same. Regs. § 3-
8.7(a).

c. South Carolina expressly rejects the use of SRLY concepts. TAM # 89-22(1989), CCH South Carolina State Tax Reporter ¶ 200-377 (basing its holding on a policy of conforming to federal rules but not referring to the SRLY rules in the federal consolidated return regulations).

d. Arizona’s Department of Revenue limits the use of a loss on a combined return to the income of the business that produced the loss. Corporate Tax Ruling No. CTR 91-2 (April 2, 1991), CCH Arizona State Tax Reporter ¶ 201-004.


f. In New York, the NOL deduction cannot exceed the federal NOL deduction. Tax Law ¶ 208.9(f)(3). If a corporation’s federal NOL is applied against the income of other corporations with which it files a federal consolidated return, it will not be available to be carried forward for New York purposes, even if the corporation filed a separate New York return for that year and the related corporations were not New York taxpayers for that year. See, Royal Indemnity Co. v. Tax Appeals Tribunal, 75 N.Y. 2d 75, 550 N.Y.S. 2d 610 (1989) (NOLs carried back and exhausted for federal purposes could not be carried forward for New York State purposes even though corporation was not a New York taxpayer during the carryback years).

4. The states have different rules governing the effect of acquisitions on NOL carryovers. The rules in each state in which T does a significant amount of business must be reviewed in planning an acquisition.