STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DUNK & BRIGHT FURNITURE CO., INC.	:	
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2005 through February 29, 2008.	:	DETERMINATION DTA NOS. 823026 AND 822710
In the Matter of the Petition	:	
of	:	
JAMES F. BRIGHT	:	
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2005, 2006 and 2007	:	

Petitioner Dunk & Bright Furniture Co., Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2005 through February 29, 2008. Petitioner James F. Bright filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 2005, 2006 and 2007.

A consolidated hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York 12180, on October 8, 2009 at 10:30 A.M., with all briefs to be submitted by April 2, 2010, which date commenced the six-month period for issuance of this determination. By a letter dated

September 27, 2010, this six-month period was extended for an additional three months (Tax Law § 2010[3]). Petitioners appeared by Hiscock & Barclay, LLP (David G. Burch, Esq., and Kevin R. McAuliffe, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Justine Clarke Caplan, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly denied petitioners' claims for qualified empire zone enterprise credits for sales and use taxes and for real property taxes based upon the determination that petitioner Dunk & Bright Furniture Co., Inc., did not have a valid business purpose as defined by Tax Law former § 208(9)(o)(1)(D) for its reorganization and that such reorganization was undertaken solely to gain empire zone tax benefits.

FINDINGS OF FACT[1]

1. Petitioner Dunk & Bright Furniture Co., Inc. (D & B Furniture) operated a retail home furnishings business established in the late 1920s and located in Syracuse, New York. Petitioner James F. Bright began working for the former D & B Furniture, then owned by his father, in 1990 and thereafter acquired the business assets from his father in 1992. At the time Mr. Bright acquired the business assets, the operations of the company included retail furniture sales (including residential retail furniture sales), carpet sales, interior design services, and shop-at-

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[1] Petitioners submitted 42 proposed findings of fact and 13 proposed conclusions of law. In accordance with State Administrative Procedure Act (SAPA) § 307(1), petitioners' proposed findings of fact have been generally accepted (in some instances after being summarized – ***see, e.g.***, proposed findings of fact 31 through 37) and made a part of the Findings of Fact herein, with the following exceptions:

(i) proposed findings of fact 27 and 28 have been modified so as to eliminate the portions thereof, which set forth conclusory statements concerning the "primary" reason for petitioners' business reorganization;

(ii) proposed finding of fact 29 has been rejected as conclusory except for the second and third sentences thereof, which have been accepted; and

(iii) SAPA does not require rulings to be made upon proposed conclusions of law and none are made herein.

home services. The company's operations remained largely unchanged from the time of Mr. Bright's acquisition of the company's assets through 1999.

2. In or about 1999, Mr. Bright began implementing changes in the company's operations. The first change was the August 1999 creation of JFB Warehouse Company (JFB), an entity whose function was to lease warehouse space and sublet that leased space to D & B Furniture as well as to approximately 10 additional subtenants. The space leased, and in turn subleased, by JFB was spread throughout a ten-story warehouse building, which had low ceiling heights and pillars within the warehouse space. This hindered the proper storage of furniture. In addition, it was very labor intensive and expensive for D & B Furniture to carry on the furniture storage and delivery operations of its business from a multi-story facility.

3. The forgoing lease/sublease continued until 2004. During this time period, Mr. Bright actively sought different warehouse space to address the noted unsatisfactory aspects of D & B Furniture's arrangement with JFB and its warehouse facility. He considered several options, including leasing or acquiring existing warehouse space, and constructing and owning new warehouse space. As part of this process, Mr. Bright engaged V.I.P. Structures to provide schematic plans for two different warehouse structures to be built at the South Salina Street property where D & B Furniture's existing showroom was located. One plan involved a 50,000 square foot stand-alone warehouse building, while the second plan involved a 50,000 square foot addition to the existing showroom. The ultimate proposal from V.I.P. Structures contemplated a separate 56,000 to 57,000 square foot warehouse facility to be constructed at a cost of approximately $1.4 million dollars.

4. In anticipation of constructing the warehouse, Mr. Bright obtained permission to subdivide the existing property into multiple lots and obtained a change in its zoning from

residential to business. He also applied for a $300,000.00 grant from New York State to help defray the costs of building the warehouse. Mr. Bright applied for the grant in the name of D & B Furniture or its assigns so that he would have the flexibility to move forward with the warehouse project using an entity separate from, but related to, D & B Furniture. Mr. Bright ultimately received $150,000.00 in grant money to use toward the purchase of equipment and the expansion of the existing Dunk & Bright furniture showroom facility to provide for, among other things, facade renovations, the separate building housing the new commercial furniture showroom and carpet warehouse display, and expanding the existing parking lot.

5. The subdivision and related zoning changes were undertaken so as to separate the property on which Mr. Bright intended to construct the warehouse from the property on which the furniture business was located, such that in the event the furniture company went out of business, he would still have a separate warehouse building on his own property that would be insulated from the furniture business and could be sold. In addition, this plan afforded Mr. Bright greater flexibility with respect to financing the construction of the warehouse, separated the furniture business from the warehouse business, and provided for him a separate real estate investment.

6. During this same time period, Mr. Bright also considered purchasing or leasing existing warehouse space and made offers to purchase or to lease on more than one property. He intended that any purchase offer or lease that came to fruition could be assigned to an entity created for the purpose of acquiring and owning or leasing the space.

7. One of the buildings Mr. Bright considered purchasing for warehouse space was owned by Cooper Industries. This property was available at a very low cost because it had environmental contamination. Mr. Bright was advised by legal counsel that if he purchased this

property, it would be important for him to take title to the property via an entity separate from D & B Furniture in order to protect the operating business from the liabilities associated with environmental contamination.

8. In 2001, in addition to being the sub-landlord to D & B Furniture and the other subtenants, JFB assumed the responsibility for delivering the furniture sold by D & B Furniture. This service had previously been provided by AAK Delivery, an unrelated enterprise. JFB also provided delivery services for a furniture leasing company owned by Mr. Bright's father. Having JFB provide furniture deliveries reduced the costs and increased the efficiency and flexibility of such deliveries, providing Mr. Bright with direct control over the delivery of furniture and over resolution of customer complaints arising from damage to the furniture or to customers' homes during delivery. At the same time, Mr. Bright had concerns about liabilities such as broken down trucks, hiring drivers, damaged furniture, and accidents involving trucks and drivers in connection with JFB's assumption of furniture deliveries for D & B Furniture. In addition to these concerns, the warehouse space JFB subleased to D & B Furniture and the other subtenants was located in an old, multi-story structure, and included elevators of a design that was a potential danger to individuals lacking full knowledge of their proper use and operation. As noted there were multiple tenants in the building, and as a result there were many individuals, both employees and nonemployees of the various tenants, who moved unrestricted throughout the building. The potential liability from these circumstances was of concern to Mr. Bright, including the potential for claims that might impact the assets of D & B Furniture's operations.

9. Mr. Bright and his financial advisor, James E. Kane, had discussed the foregoing concerns about liability, and Mr. Kane recommended the possibility of separating the operations of JFB into separate entities so as to segregate the liabilities associated with the subleasing of

warehouse space and the liabilities associated with the furniture delivery from the furniture business itself. Mr. Bright had considered reorganizing into various entities in connection with the issue of segregating potential liabilities and with his desire to expand his business.

10. JFB provided furniture delivery services for D & B Furniture from 2001 through March 2002. At that point, Mr. Bright had a comprehensive understanding of the furniture delivery business, and recognized that he could make greater profit if furniture delivery was directly handled through D & B Furniture. Mr. Bright worked directly with his insurance advisors to guard against the noted liability concerns he continued to have with respect to the delivery business, and his insurance advisors convinced Mr. Bright that he could substantially mitigate the risks associated with the delivery business more easily if it was part of D & B Furniture. While D & B Furniture thereafter undertook the furniture delivery operations, JFB continued, until 2004, to provide furniture delivery services to the furniture rental company owned by Mr. Bright's father.

11. Ultimately, in 2004, Mr. Bright located modern, cost-effective warehouse space on Steelway Boulevard South, Liverpool, New York, offering warehouse space on one level and having ceilings of sufficient height to allow for adequate racking to be installed for proper furniture storage. The warehouse owner was willing to lease the space directly to D & B Furniture without need of a personal guarantee from Mr. Bright. In contrast, however, if the tenant was to be an entity other than D & B Furniture, the owner would require Mr. Bright to sign a personal guarantee of the lease. Mr. Bright determined that since, unlike his existing warehouse space, there would be no subtenants under this new lease, he could address his liability concerns via proper insurance coverage and risk-management procedures. Accordingly,

he decided that D & B Furniture would lease the property as tenant, thereby eliminating the need for Mr. Bright to personally guarantee the lease.

12. Throughout the late 1990s and early 2000s, Mr. Bright pursued other business opportunities toward his business expansion goal. He modernized and expanded his existing commercial and retail carpet operation, including the acquisition of a separate software system to serve the carpet operation. He also began a commercial furniture operation for which he purchased a separate software system that allowed the designers on staff to prepare three dimensional design renderings such as those depicting a collection of workstations. The employees who worked in the carpet operations and the commercial furniture operations were located in a different building from the retail furniture operations (***see*** Finding of Fact 4) and their compensation was handled independently from that of the retail furniture operation's employees.

13. Mr. Bright and Mr. Kane also discussed creating separate entities with respect to the carpet operations and the commercial furniture operations, in consideration of the desire to segregate the liabilities of the various operations as well as to isolate the profits of each of the operations from the others. In this latter regard, the incentives and rewards used to encourage employees to improve their performance could be simplified in that only those profits attributable to the particular operation in which a given employee worked would be considered for additional incentive or reward remuneration. Further, creating separate entities for the different operations would provide separate businesses that could be acquired by Mr. Bright's children or sold (separately) to third parties. Mr. Bright and Mr. Kane also discussed other advantages of having separate entities, including the ability to mortgage different assets without the necessity of guaranteeing such mortgages with the assets of an operating company, the ability to sell assets

independently of each other, and the ability to segregate certain liabilities such as tort and environmental liabilities associated with real property ownership or leasing.

14. Notwithstanding the foregoing considerations in favor of separating the various business operations into separate entities, it was equally important to Mr. Bright that the operations could be structured such that financial statements and tax returns could be filed on a consolidated basis so that all the income from all the entities would be included in one report and lenders would be able to understand the whole of Mr. Bright's business operations. This consideration led to discussions centering on having the separate entities under one parent entity, or holding company.

15. In 2002, Mr. Bright's legal counsel, Ronald Berger, proposed a plan of reorganization (the Plan), described as a "tax planning idea," which included establishing a holding company that would provide flexibility to restructure the existing business operations, segregate the liabilities associated with such operations, and allow for the realization of additional economic incentives available under the New York State Empire Zone Program.

16. On June 21, 2002, pursuant to the foregoing Plan, Dunk & Bright Holdings, Inc. (D & B Holdings) was formed. Thereafter, on December 31, 2002, D & B Holdings acquired the assets of D & B Furniture in a tax-free reorganization pursuant to Internal Revenue Code (IRC) § 368(a)(1)(c). On January 29, 2003, D & B Holdings filed an official name change amendment changing its name to Dunk & Bright Furniture Co., Inc.[2]

17. Mr. Berger serves as the corporate secretary of D & B Holdings, with responsibility for preparing the minutes of the meetings of its board of directors (Board Minutes). Mr. Berger also

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[2] In result, D & B Holdings effectively reassumed the original company name Dunk & Bright Furniture Co., Inc. (i.e., D & B Furniture; ***see*** Finding of Fact 1). To preserve clarity, and notwithstanding this name change, the post-reorganization petitioner shall continue to be referred to herein as D & B Holdings.

prepares the official minutes of the annual D & B Holdings shareholder meeting (Shareholder Minutes). Mr. Bright is the sole shareholder and no formal shareholder meetings are held. However, shareholder minutes are prepared since Mr. Bright's lenders require annual audited financial statements which, in turn, require annual shareholder minutes. Mr. Bright gives the shareholder minutes, prepared by Mr. Berger, only a cursory review. Mr. Berger has (and had) no operating, management or decision making authority or responsibility with respect to D & B Holdings. Rather, all decision-making and day-to-day operational authority for D & B Holdings rests with Mr. Bright and with Dawnmarie Raymond (with direct oversight from Mr. Bright). Mr. Bright, as the sole shareholder, has no obligation to demonstrate to anyone any actions he plans to take in connection with his business operations, nor has he ever been requested to provide a written business plan when seeking financing and, accordingly, he does not create written business plans. In similar fashion, there is no evidence that the Plan of reorganization as proposed by Mr. Berger to Mr. Bright (***see*** Finding of Fact 15) is embodied or was presented in written form.

18. The Board Minutes for the 2002 board meeting state that the reorganization was undertaken "to maximize tax benefits." The corporate tax returns for 2002 included an attached statement that "[t]he purpose for the [reorganization] was to provide the corporate structure the flexibility to take advantage of certain New York State incentives. The details and transactions that took place in order for the reorganization to take place are included in the attached agreement." A Statement of Business Purpose, prepared by Mr. Bright and his professional advisors in connection with the subject audit and in response to questions raised therein, signed by Mr. Bright on July 18, 2007, includes a history of Mr. Bright's business and its operations and in conjunction therewith sets forth reasons, in addition to the maximization of tax benefits, for

the reorganization as noted above (i.e., segregation of liabilities, isolation of profits of the various business operations and financing considerations).

19. Ultimately, Mr. Bright did not create separate entities to own and carry on each of the different business operations, as described above. In this respect, the commercial furniture operation did not generate the anticipated rate of return and Mr. Bright decided to cease this operation. This operation as well as the carpet operation had been located in a different building from the retail furniture operation. Mr. Bright agreed to lease the building that housed the carpet operation and commercial furniture operation to Syracuse University, in connection with which he downsized the carpet operation and relocated it within the retail furniture showroom space. No separate entity was created to hold the lease of the separate building with Syracuse University.

20. The Division of Taxation (Division) commenced an income tax audit of petitioner James F. Bright for the years 2005, 2006 and 2007. In connection with this audit, the Division requested via a series of letters, information concerning the business purposes for the reorganization, including details as to the general business activities of the transferor (D & B Furniture) and transferee (D & B Holdings), how the use of assets changed and whether the principal business activity had changed with respect to the transferor after the transfer of assets pursuant to the reorganization, and explanations as to concerns about potential liability in the trucking (furniture delivery) operation. Pursuant to these letters, the Division sought various documents, including internal memos, e-mails, correspondence with consultants, representatives, and outside third parties, a list of the boards of directors for the transferor and transferee, copies of board minutes pertaining to the creation of the holding company, correspondence with the Empire State Development Corporation (ESDC), and an explanation for why JFB Warehouse,

Inc. was not moved into D & B Holdings, as was D & B Furniture. The Division also requested any documents explaining why "Holdings" was a more suitable tenant than "Warehouse," and an explanation of what tax benefits the board of directors was referring to in the December 2002 minutes.

21. In response to these letter requests for information and documentation, petitioners (by Mr. Kane) included a statement of business purpose, a statement that no written documentation existed to detail the liability concerns associated with the operation of the warehouse or the furniture delivery business, a statement that no written business plan existed relative to the reorganization, and an explanation that "Mr. Bright and Mr. Berger stated that the reference to tax benefits referred to the Empire Zone credits that would be available to the corporation if they registered and were approved as a Zone Certified Business."

22. In addition to the income tax audit, the Division also conducted a sales tax audit of petitioner D & B Furniture (i.e., D & B Holdings) for the period spanning December 1, 2004 through February 29, 2008. The Division concluded, as is relevant to these proceedings and upon the information supplied and conclusions reached in the income tax audit, that this petitioner did not meet the "valid business purpose test" in connection with the reorganization of D & B Furniture into D & B Holdings and as a result was not entitled to the Qualified Empire Zone Enterprise (QEZE) exemption taken for sales tax purposes.[3]

23. On September 22, 2008, the Division issued to petitioner James F. Bright and Cynthia Bright three notices of deficiency asserting additional personal income tax due in the amounts of $67,621.02 for 2005, $69,952.19 for 2006 and $77,622.32 for 2007, plus interest, based upon the

[3] To the extent the sales tax audit resulted in disallowance of Dunk & Bright Holding's claimed QEZE based sales tax exemption the same is premised, essentially, on the income tax audit investigation and the conclusions arrived at as result thereof, without further significant sales tax audit investigation.

disallowance of QEZE based real property tax credits claimed for each of such years.[4] On February 2, 2009, the Division issued to petitioner Dunk & Bright Furniture Co., Inc. (i.e, D & B Holdings) a Notice of Determination assessing sales and use tax due for the period spanning December 1, 2005 through February 29, 2008 in the amount of $41,030.53, plus interest, based upon disallowance of the company's QEZE based sales tax exemption.[5]

SUMMARY OF THE PARTIES' POSITIONS

24. Petitioners assert that the reorganization of D & B Furniture into D & B Holdings was undertaken for valid business purposes and not solely for the purpose of gaining entitlement to the noted QEZE tax benefits. Petitioners do not dispute that gaining such tax benefits was one of the aims or motivations in undertaking the reorganization, but claim that there were overriding purposes motivating the transaction. In particular, petitioners posit that structuring D & B Furniture's business within a holding company would allow for greater flexibility in segmenting the various components of the business into separate entities so as to isolate potential liabilities associated primarily with the warehousing and delivery aspects of the furniture business from the sales (operational) aspects of the business. Petitioners maintain that this structure would also facilitate tracking or identification of the profits or earnings from the various business segments so as to allow proper and accurate incentives to be offered and awarded to employees in their particular segment of the business. Petitioners state that having separate entities within a holding company structure could also serve to simplify and clearly delineate banking relationships among

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[4] Cynthia Bright's name appears solely by virtue of having filed joint personal income tax returns with petitioner James F. Bright for each of the years in issue.

[5] The Division also concluded that D & B Holdings owed additional sales tax in the amount of $28,531.82. The Notice of Determination issued with respect to this amount of tax has been paid and is not contested. While the Notice of Determination premised upon the Division's disallowance of QEZE based sales tax exemption has likewise been paid, it remains at issue and is contested herein.

such companies, while still affording a means of showing all revenue streams together (via the holding company), which could reduce the tendency of financial institutions to seek cross collateralization on loans, protect the assets of different operating entities, and reduce the need for personal guarantees by D & B Furniture's sole shareholder, Mr. Bright. Petitioners also claim that such a structure could reduce costs and management issues by having individual entities that were fully independent operating units. Petitioners further maintain that having separate entities would allow for easier sale of separate business segments represented by such entities, and noted that such a structure could facilitate succession planning for Mr. Bright. In sum of the foregoing, petitioners claim, without denying that obtaining QEZE tax benefits was a motivating factor, that the primary purposes motivating the reorganization were to achieve isolation of liabilities while still showing earning and income consolidation.

25. The Division, in contrast, asserts that to prove entitlement to the QEZE real property tax credits and sales and use tax exemption in question, petitioners must show that there was a "valid business purpose," as specifically defined in Tax Law former § 208(9)(o)(1)(D), for the creation of D & B Holdings such that this entity constituted a "new business." Specifically, the Division maintains that petitioners must prove that they had a purpose or purposes other than the avoidance or reduction of taxes, that the nontax purpose or purposes for which the reorganization was undertaken constituted the principal motivation for the formation of D & B Holdings, and that such reorganization resulted in a meaningful change in the economic position of the enterprise. In addition, petitioners must establish that the reorganization was not solely for the purpose of gaining QEZE tax benefits. In disallowing the claimed benefits, the Division notes that the documentary evidence that is contemporaneous to the formation of D & B Holdings, referred to in the Division's brief as the formation documentation, shows that the reorganization

was undertaken solely to gain Empire Zone tax benefits. The Division notes that petitioners undertook the reorganization in late June 2002 (i.e., shortly before the August 1, 2002 end date for QEZE certification), a factor which the Division contends demonstrates that gaining Empire Zone tax benefits was the primary motivation for the reorganization. The Division further argues that the legitimacy of petitioner's claimed nontax business reasons for the reorganization is questionable since the same were offered for the first time after the Division sought, upon audit, further particulars concerning the process and purposes for which the reorganization was undertaken. The Division points out, in this respect, that no activities in furtherance of the claimed reasons for reorganization were ever undertaken post-reorganization, and that there is no evidence that the reorganization caused any meaningful economic change in operation or outcomes of petitioners' business.

CONCLUSIONS OF LAW

A. The Economic Development Zone Program (the Program), created by the Legislature in 1986, was intended to attract jobs to and facilitate development and opportunity in blighted areas of the state. Qualified businesses could become certified and eligible to receive certain tax credits and exemptions directly linked to job creation. In very general terms, the level of tax benefit derived from job creation for a given period was determined by a comparison of the number of jobs a qualified and certified business had in a base period to the number of jobs it had in a particular subsequent period.

B. As is relevant to this matter, Tax Law § 14(a) provides that a business enterprise which is certified under Article 18-B of the General Municipal Law and meets the employment test shall be a "qualified empire zone enterprise." Tax Law § 15(a) provides that a taxpayer which is a qualified empire zone enterprise subject to tax under Article 9-A of the Tax Law shall be

allowed a credit against such tax for eligible real property taxes. Tax Law former § 1115(z) provides, similarly, for the benefit of an exemption from the four percent New York State sales and use taxes imposed upon certain purchases and uses of tangible personal property and services by a business enterprise which is a qualified empire zone enterprise. There is no dispute that D & B Furniture met the foregoing requirements when it claimed the QEZE credits and exemption for tax periods prior to those at issue herein. However, the level of D & B Furniture's QEZE tax benefit was limited to approximately ten percent of the maximum allowable credit due to the limitation of D & B Furniture's employment increase factor. In order to increase its tax benefit amount, D & B Furniture had to either a) increase its employment level to twice its base year employment level, or b) become a "new business" so that, with a base period employment level of zero, the addition of one job would result in its entitlement to 100 percent of the available QEZE tax benefit.

C. After the year 2000, the circumstance whereby an existing business could simply form a new entity (e.g., by the simple expedient of reincorporation) so as to qualify for benefits that an existing business could not have received (or increase the level of QEZE tax benefits being received by the existing business), was identified by the Legislature as a loophole, known colloquially as "shirt changing," which was inconsistent with the intent of the Program. In response, on May 22, 2002 the Legislature acted to close this perceived loophole with respect to businesses created on or after August 1, 2002, by requiring such businesses to qualify as new businesses. This legislative change resulted in a significant increase in the number of businesses being incorporated (or reincorporated) in the period between the May 22, 2002 change in the law and its August 1, 2002 "cutoff" date after which new business qualification was required. This increase in "new" business formation was itself perceived as an additional loophole opportunity,

within a window period, to gain entitlement to, or an increase in, QEZE tax benefits. To curtail this further perceived loophole, the Legislature added an additional requirement whereby businesses first certified as eligible to receive QEZE tax benefits prior to August 1, 2002 had to establish that they had been created for a "valid business purpose," as such was specifically defined, and had not been created solely for the purpose of gaining QEZE tax benefits. Businesses certified prior to August 1, 2002 were entitled to continue receiving QEZE tax benefits until tax periods beginning on or after January 1, 2005, at which time the valid business purpose test became effective as to such businesses.

D. As described above, commencing with tax years beginning on or after January 1, 2005, chapter 161 of the Laws of 2005 amended Tax Law § 14(b)(1) to provide that:

> For entities first certified prior to August first, two thousand two, if the entity had a base period of zero years or zero employment in the base period, then the employment test will be met only if the enterprise qualifies as a new business under subdivision (j) of this section.

By virtue of the fact that D & B Holdings was created (via reorganization) on June 21, 2002, was certified eligible to receive QEZE benefits thereafter prior to August 1, 2002, was essentially identical in ownership and operation to its immediate predecessor D & B Furniture, and had zero employees in its base period, it is a business that will meet the employment test only if it meets the new business "valid business purpose" test which, as set forth in Tax Law former § 14(j)(4)(B), provides that a corporation or partnership:

> shall not be deemed a new business if it was not formed for a valid business purpose, as such term is defined in clause (D) of subparagraph one of paragraph (o) of subdivision nine of section two hundred eight of this chapter and was formed solely to gain empire zone benefits.

E. In turn, Tax Law § 208(9)(o)(1)(D) defines the term "valid business purpose" as follows:

> A valid business purpose is one or more business purposes, other than the avoidance or reduction of taxation, which alone or in combination constitute the *primary* motivation for some business activity or transaction, which activity or transaction changes in a meaningful way, apart from tax effects, the economic position of the taxpayer. The economic position of the taxpayer includes an increase in the market share of the taxpayer, or the entry by the taxpayer into new business markets (emphasis added).

F. From the foregoing, in order to qualify as a new business and consequently establish entitlement to the QEZE benefits of sales tax exemption and real property tax credits sought for the years and periods at issue herein a two-fold standard must be met. First, it must be shown that the reorganization of D & B Furniture as D & B Holdings (i.e., the formation of D & B Holdings) was undertaken for one or more business purposes, which purposes, alone or together *but apart from and excluding tax avoidance or reduction purposes*, constituted the *primary* motivation for the reorganization the result of which must have meaningfully (and apart from tax considerations) changed the economic position of the business. Second, it must also be shown that the reorganization was not undertaken solely in order to gain QEZE benefits. Since the QEZE benefits referred to are undeniably tax benefits (i.e., real property tax credits and sales and use tax exemption), it follows that such tax benefit impact applies to both parts of the foregoing two-part standard for entitlement to QEZE tax benefits. That is, in order to be entitled to the QEZE tax benefits at issue, obtaining such QEZE tax benefits can not have been the *sole* purpose for undertaking the reorganization and, further, gaining the benefit of tax avoidance or reduction, either as to taxes in general or in particular as the result of realizing such QEZE tax benefits, can not have been the *primary* purpose for undertaking the reorganization.

G. Petitioners recognize the standard for eligibility as a two-fold test, but cast the same as a two-fold test of disallowance. As viewed by petitioners, if either part of the two-fold standard

is not met, then entitlement to QEZE tax benefit may not be disallowed. That is, petitioners argue that in order to be denied new business status, and consequently be ineligible for QEZE tax benefits, the Division must make both a determination that the reorganization was undertaken solely in order to gain QEZE tax benefits and must establish that there was no valid business purpose for the reorganization (i.e., that the alleged nontax purposes motivating the reorganization were not the primary purposes therefor). Accordingly, petitioners would argue that if the evidence supports a conclusion that the reorganization was undertaken for *any* valid business purposes in addition to tax avoidance or reduction, then the reorganization could not have been undertaken *solely* to gain QEZE tax benefits, thus leaving one part of the two-part standard for disallowance unmet and resulting in entitlement to such QEZE tax benefits.

H. Petitioners' view, described above, leads to the inapposite conclusion that if QEZE tax benefit entitlement was not the sole purpose for the reorganization, then the taxpayer must therefore prevail notwithstanding its failure to meet the valid business purpose test of Tax Law former § 208(9)(o)(1)(D). This view, however, fails to acknowledge the very specific definition of "valid business purpose" set forth in Tax Law former § 208(9)(o)(1)(D) in that it essentially overlooks the requirement that nontax business purposes must have been the *primary* motivation for the reorganization. More to the point, adopting petitioners' position would not only read confusion into the statutory language, but in fact would reverse and place the burden of proof on the Division, in contravention of Tax Law § 689(e); § 1089(e) and 20 NYCRR 3000.15(d)(5). On this score, it is well established that taxpayers bear the burden of proving entitlement to the tax credits and exemptions they seek (***see e.g. Matter of Brookfield Power New York Corp.***, Tax Appeals Tribunal, November 10, 2010).

I. Petitioners' position, as detailed, is that in order to support disallowance of the QEZE tax benefits at issue in this case, the Division was obligated to make a showing that the "new" entity (D & B Holdings) was formed solely to gain QEZE tax benefits. Petitioners maintain that the Division's denial of such benefits should be reversed due to its failure to meet this obligation (i.e., its failure to meet one part of the two-part standard for disallowance.) As noted, this position essentially, and incorrectly, places the burden of establishing nonentitlement on the Division. Instead, the correct position requires petitioners to meet both parts of the two-part standard by establishing that the reorganization was not undertaken solely in order to gain QEZE benefits and, further, that the reorganization was not undertaken primarily to gain the benefit of tax reduction or avoidance (including therein tax reduction as the result of gaining QEZE benefits, which are clearly tax benefits.) In turn, review of the entire record supports the conclusion that petitioners have not met either part of the two-part test required to establish entitlement to the QEZE tax benefits at issue. Instead, the evidence shows that at the time of reorganization, tax avoidance or reduction based on continuing entitlement to and increasing petitioners' level of QEZE tax benefit to its maximum limit, as opposed to the other claimed business purposes, was not only the *primary* motivation for reorganization but in fact was petitioners' *sole* reason for reorganizing.

J. In examining the record to determine whether there existed at the time of the reorganization a valid business purpose, as specifically defined and as apart from securing tax benefits, one must look to whether the entirety of petitioner's actions over time bear out such claim. In its brief, the Division states that there was no valid business purpose for the reorganization of D & B Furniture into D & B Holdings apart from maximizing QEZE tax benefits. This position is based on the minutes of a board of directors meeting and on the

statements included with the filing of tax returns which speak, in each instance, only of maximizing such benefits. These documents are referred to in the Division's brief as "the formation documentation." The Division contends that these documents are the most contemporaneous to the date of the reorganization and thus are the most reliable indication of the purpose for the reorganization. It is true that the contemporaneous documents to the formation of D & B Holdings (i.e., the minutes of board of directors meeting and the tax filings) speak only to maximizing the available QEZE tax benefits to be derived from the reorganization. For their part, petitioners candidly admit that maximizing QEZE tax benefits was the purpose from the perspective of the attorney who suggested and carried out the reorganization. At the same time, however, petitioners maintain that there existed several reasons and purposes apart from the QEZE tax benefits for taking this step. Ultimately, then, the question devolves to whether it is reasonable to accept that the various stated business reasons for reorganization would have resulted in the reorganization of D & B Furniture as D & B Holdings *absent* the availability of the QEZE tax benefits resulting therefrom.

K. While not necessarily dispositive on the question of valid business purpose per Tax Law former § 208(9)(o)(1)(D), the single purpose statements in the minutes and in the tax filings, even in the case of a relatively small, one-shareholder business, are nonetheless clearly a significant factor supporting QEZE tax benefit maximization as the sole purpose for the reorganization. Likewise, the timing of the reorganization, undertaken as it was just after the amendment to the law and shortly prior to the close of the resulting window of eligibility for new businesses, is a factor which militates against a conclusion that the reorganization was motivated *primarily* by nontax considerations. At the same time, it is clear from his course of action that Mr. Bright wanted to improve his business by acquiring (by lease or construction) a more

suitable warehouse facility, a process which had been ongoing for a number of years, and also sought to expand his business by engaging in additional lines of furniture sales, as described. In achieving these aims, Mr. Bright wanted to ensure that the debts and other financial exposures of warehousing and furniture delivery were isolated from the furniture sales line of business, desired to minimize the need to cross-collateralize operations and minimize personal financial guarantees, segregate performance results among the various business components so as to be able to provide appropriate performance-based employee incentives to those working in the various areas of the company's overall business endeavors, yet still show combined business results for financing purposes. In sum, Mr. Bright sought liability separation (or segregation) with earnings consolidation. However, upon consideration of the entire course of events, it cannot be said the additional motivations or considerations described above, either alone or in combination, as opposed to the clearly stated purpose of gaining the maximum QEZE tax benefit, have been shown to be the primary motivation for the reorganization.

L. Petitioners note that at the time the reorganization was undertaken, there was no requirement for documentary proof concerning the valid business purpose test, and that to expect the same puts petitioner at a significant "after-the-fact" disadvantage. Petitioners are not, as claimed, being "punished" for not having contemporaneous documents outlining the many claimed motivations for the subject transaction. Rather, given that the existing contemporaneous documents list only the QEZE tax benefit maximization as the purpose for the transaction results in a situation where petitioners' lack of inclusion of any other purposes leaves the actual post-reorganization activities as the best means of overcoming the stated purpose of QEZE tax benefit gain as both the primary and the sole purpose for the reorganization. Here, unfortunately, there were no post-reorganization actions that were consistent with the claimed reasons for having

undertaken the reorganization. Petitioners' position would be far more compelling if at least some steps were actually undertaken that were consistent with or in some more obvious manner in furtherance of the after-the-fact stated purposes. In this respect, petitioners' pre- and post-reorganization activities represented ongoing business growth effects that were (and almost certainly would have been) undertaken regardless of the reorganization. None of the activities (e.g., adding new lines of furniture from different furniture makers, commencing the sale of commercial office furniture, or expanding carpet sales) in any way seem to be a result of, prompted, or caused by the subject reorganization. While the noted reasons for reorganizing are all legitimate and valid reasons for undertaking such a transaction, petitioner has provided no evidence of having engaged in any subsequent activities consistent therewith. None of the other business activities or segments which were to be made separate entities and brought under the umbrella of the holding company were ever made separate entities. It is also significant that the only separate entity in existence at the time of the reorganization, JFB Warehouse, was itself never brought under such holding company, so as to address the concerns about liability expressed with respect to JFB's activities. Similarly, no separate entity was created to hold the lease of the separate building formerly housing the carpet business to Syracuse University. It is obviously difficult to accept the premise that any meaningful economic or other changes in business resulted from the reorganization, given that none of the envisioned steps or activities available under the business structure as reorganized were ever undertaken or carried out. This fact further undermines the claim that the nontax reasons were the primary motivation for the reorganization. While petitioners' business seems to have grown and improved, there is no apparent connection between such growth, or change in market share or any like economic consequence, which may be said to have resulted from the reorganization itself. In view of these

circumstances, it simply cannot be concluded that any of the post-reorganization reasons for having undertaken the reorganization, as advanced in the face of audit inquiry, either alone or in combination constituted the primary purpose for having entered into the reorganization, or that such reorganization caused or resulted in a meaningful change in petitioners' economic position. In sum, the circumstances and evidence clearly support the conclusion that the reorganization was undertaken for the sole and primary purpose of allowing petitioners to gain the maximum QEZE tax benefits available, with any other potential benefits neither borne out as significant, acted upon, or anything other than considerations ancillary to gaining such QEZE tax benefits. Under this conclusion, D & B Holdings cannot qualify as a new business and thus the Division properly disallowed the QEZE based tax credits and exemption claimed by petitioners.

M. The petitions of Dunk and Bright Furniture Co., Inc., and James F. Bright are hereby denied, and the Notice of Determination dated February 2, 2009 and the notices of deficiency dated February 22, 2008 are sustained.

DATED: Troy, New York
December 30, 2010

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE