STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
WARD LUMBER CO., INC.	:	ORDER
for Redetermination Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 2005, 2006 and 2007.	:	DTA NOS.823163 AND 823209

Petitioner, Ward Lumber Co., Inc., filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 2005, 2006 and 2007.

On April 28, 2011, the Administrative Law Judge issued a determination, which denied the petitions and sustained the Division of Taxation's denials of petitioner's Empire Zone benefits claimed for the years at issue.

On July 10, 2012, the Tax Appeals Tribunal granted petitioner's exception, reversed the determination of the Administrative Law Judge, granted the petitions and ordered the Division of Taxation to retract its letters of denial, dated May 8, 2008, and April 14, 2009, and further ordered the Division of Taxation to grant the credits at issue to petitioner.

By letter dated August 9, 2012, petitioner, appearing by Hiscock & Barclay LLP (David G. Burch, Jr., Esq., of counsel), brought an application for costs under Tax Law § 3030.

The Division of Taxation, appearing by Mark F. Volk, Esq. (Robert Tompkins, Esq., of counsel), filed a response to the motion for costs dated September 24, 2012, which date began the 90-day period for issuance of this order.

Based upon petitioner's application for costs, accompanying affidavits and documentation, the Division's response to the motion for costs, the determination issued April 28, 2011, the decision issued July 10, 2012 and all pleadings and proceedings had herein, Thomas C. Sacca, Administrative Law Judge, renders the following order.

ISSUE

Whether petitioner is entitled to an award of costs pursuant to Tax Law § 3030.

FINDINGS OF FACT

1. Petitioner, Ward Lumber Co., Inc., a Delaware corporation, is a building materials manufacturer and supplier formed in December 2001. Prior to its formation, the business presently conducted by petitioner was conducted by a different entity that was incorporated in the State of New York in 1961. The entity incorporated in the State of New York in 1961 was also named Ward Lumber Co., Inc.[1]

2. Petitioner carries on a fourth-generation family-owned business, which has operated in Jay, New York, for approximately 120 years. Although the business has always been carried on by the Ward family, it has gone through a number of intergenerational transfers over the past 120 years. In early 1996, Ward Lumber I's shareholders consisted of Sidney Ward, Jr., his wife, Janet Ward, and their two sons, Jay Ward and Jeff Ward. The ownership percentages were such that Jay and Jeff Ward owned slightly less than 50 percent combined, with the remaining shares owned by Sidney Ward, Jr., and Janet Ward. Sidney and Janet Ward retired in 1996, and as part of their retirement plans, began periodically transferring shares to Jay and Jeff Ward, equally in all cases.

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1 To maintain clarity, the original Ward Lumber Co., Inc., will be referred to herein as "Ward Lumber I," and the current Ward Lumber Co., Inc., will be referred to herein as "petitioner."

3. In 1992, Jay Ward became president of Ward Lumber I, while still managing the Building Material Division. When Jay Ward became president, Jeff Ward was elevated to senior vice-president of Ward Lumber I, with his responsibilities focused on managing the Lumber Manufacturing Division. Beginning in 1996, Ward Lumber I began to rapidly grow through acquisitions and expansions of its retail locations.

4. Despite its long history, Ward Lumber I was struggling financially prior to its merger into petitioner. While it realized steady profits from 1994 to 1999, Ward Lumber I experienced a rather drastic change in financial condition during the years 2000 and 2001, when it incurred operating losses of approximately $1.4 million.

5. Several factors contributed to Ward Lumber I's economic downturn and unstable financial condition. Primarily, these factors were: economic distress in the lumber and building supply industry; mounting competition from Canadian companies; inefficient and outdated equipment in the lumber mill prompting an urgent need to modernize; high employee turnover; rapid rise in production of industrial grade lumber in the mill, which was sold for a loss; and rapid growth and expansion over a five-year period.

6. As financial losses mounted between 2000 and 2001, Ward Lumber I struggled to make its debt service payments to its primary financial lender, NBT Bank, N.A. (NBT). The bank's regulators downgraded Ward Lumber I's loan credit rating from an "A" to a "C." Accordingly, NBT, through its account representative and vice president, and other senior officials, attended frequent meetings with Ward Lumber I to discuss the bank's concerns with the company's financial viability and various options to return the company to profitability. One option frequently suggested by NBT was closing down the mill and liquidating its assets.

7. To avoid closure of the mill, Ward Lumber I attempted to address NBT's concerns by scrutinizing expenses, reducing senior management salaries by eleven percent, eliminating Ward Lumber I's 401(k) matching contributions for employees, changing health insurance plans to lower costs, downsizing staff and reducing hours of operation. It also actively sought assistance from other organizations and agencies, including the Essex County Industrial Development Agency (Essex County IDA), the Empire State Development Corporation (ESDC) and New York State Energy Research and Development Authority (NYSERDA), as potential funding sources.

8. In 2000, the Essex County IDA invited Ward Lumber I to attend a certain Empire Zones Program Informational Seminar (Empire Zones Seminar) held on October 17, 2000, at the Moriah Business Park in Mineville, New York. At the Empire Zones Seminar, speakers from the Empire Zones Program for Empire State Development, the New York State Department of Taxation and Finance, and the Moriah, Port Henry, Essex Empire Zone, discussed generally the Empire Zones Program, and how both new businesses and existing businesses became eligible for Empire Zone benefits. Among the items discussed was the requirement that an existing business would have to attain a new tax identification number and form a new entity in order to qualify for the benefits available through the Empire Zones Program. Jay Ward attended the Empire Zones Seminar on behalf of Ward Lumber I.

9. In or around early 2001, and at the urging of various professional advisors, Jay Ward began his pursuit of Empire Zone benefits. It was contemplated that the Empire Zone benefits would be an inducement to NBT to continue to loan money to petitioner. Financial stability as a business purpose for the new entity meant that NBT was looking to the cash from the Empire Zone credits as part of financial stability to justify further lending. Jay Ward and Ward Lumber I's accounting manager began the process by collaborating with the Essex County IDA and the

Moriah-Port Henry Economic Development Zone office to obtain the necessary boundary revision to include Ward Lumber I's building footprint within the Essex County/Moriah-Port Henry Empire Zone. Ward Lumber I's shareholders then determined to reorganize into a new Delaware corporation. In 2001, the shareholders formed a corporation in Delaware known as "Glen Road Lumber, Inc.," which later changed its name to "Ward Lumber Company, Inc.," upon the dissolution of Ward Lumber I in New York. After locating the business within the Zone, and effectuating the merger of the business into a Delaware corporation, petitioner submitted its application for Empire Zone certification, obtained approval of its application from the local board, and ultimately obtained the necessary approval from the New York State Empire Development Office. Petitioner was certified under Article 18-B of the General Municipal Law as a Qualified Empire Zone Enterprise (QEZE) in Essex County on March 2, 2002, and in Franklin County on December 30, 2003. Petitioner received Empire Zone benefits for tax years 2002, 2003 and 2004.

10. Additional recommendations made at an Essex County IDA task force meeting included pursuit of grants available through ESDC and NYSERDA Energy $mart Loan Fund approval. ESDC was able to provide Ward Lumber I with some grant assistance, and Ward Lumber I was approved for a $350,000.00 NYSERDA Energy $mart Loan on July 24, 2001. Both the ESDC and NYSERDA funds were used to induce NBT to extend additional financing in the amount of $550,000.00 for a much-needed head rig band saw (Band Saw Loan) to reduce energy consumption in 2001.

11. The shareholders of Ward Lumber I and petitioner were the same before and after the merger, and they maintained their respective percentages of ownership.

12. In 2001, petitioner, in the name of "Glen Road Lumber, Inc.," had filed a general business corporation franchise tax return, Form CT-4, and a U.S. corporation short-form income tax return, Form 1120-A. The affirmation attached to Form 1120-A included a statement given under penalty of perjury and signed by Jeff Ward that stated:

> The purpose of the reorganization was to create a new corporation which would be eligible for economic development incentives and benefits under state law as a certified business in a local economic development zone. These economic development incentives and benefits are of substantial economic and business value to the corporation.

The Form CT-4, Form 1120-A and the attached affirmation were prepared by petitioner's accountant and signed by Jeff Ward. In general, Jay Ward is the company officer who typically reviews and signs tax returns on behalf of petitioner, but he relies heavily on petitioner's accountant to prepare all tax returns.

13. Prior to the merger in December 2001, Ward Lumber I had an overall loss of at least $700,000.00. After the merger in 2002, petitioner reduced its overall loss to $350,000.00. Petitioner began to turn its financial condition around and realized a $127,000.00 profit in 2003, and an $829,000.00 profit in 2004. The increase in profits after the merger and the closure of petitioner's component plant afforded the start-up of a livestock equipment company.

14. Due to positive improvements in petitioner's financial condition, NBT continued the extension of petitioner's $3.3 million revolving line of credit, including a temporary increase of $300,000.00 until August 31, 2002. The temporary increase of the line of credit to $3.6 million required personal limited guarantees of retired shareholders Sidney Ward, Jr., and Janet Ward up to $500,000.00. Such guarantees were released after petitioner was able to pay off an additional $500,000.00 in the summer of 2002. Other contributing factors to petitioner's improved financial condition after the merger included cost-reducing initiatives taken by management to

address NBT's concerns, as well as receipt of Empire Zone benefits in the amount of $180,000.00 over a three-year period, from 2002 to 2004.

15. For each of the applicable tax years 2005, 2006 and 2007, petitioner filed a Form CT-3, general business corporation franchise tax return. Included with the returns were claims for QEZE tax reduction credits, Form CT-604, and claims for QEZE real property tax credits, Form CT-606. For the applicable tax years, petitioner claimed the following amounts as QEZE tax reduction credits: $312.00 in 2005; $538.00 in 2006; and $138.00 in 2007. For the applicable tax years, petitioner claimed the following amounts as QEZE real property tax credits: $61,408.00 in 2005; $69,502.00 in 2006; and $65,681.00 in 2007.

16. Attached to the CT-604 and CT-606 forms for tax years 2005, 2006 and 2007 was a Schedule G Statement outlining, in general, the multiple reasons claimed for the formation of petitioner in 2001, and asserting that petitioner "was formed for valid business purposes" and "was not formed solely to gain Empire Zone benefits."

The Schedule G Statement filed for the years 2005, 2006 and 2007 stated that Ward Lumber I had lost approximately $1,500,000.00 in 2000 and 2001, due in part to competition and outdated equipment. The statement indicated that Ward Lumber I's lending institution had raised the possibility of shutting down the saw mill and liquidating the operations. Ward Lumber I was in breach of covenants under the loan documents, and the risk level with respect to the loans had drawn review and oversight by the bank's credit committee and the U.S. Office of the Comptroller of the Currency. According to the statement, Ward Lumber I was faced with three choices: shut down and lay off its employees; build a new mill for over $10,000,000.00; or develop a plan acceptable to the bank (from which forbearance and additional funds would be needed) to retool the existing facility over time to enable it to compete with the Canadian mills.

The statement further explained that the ESDC, the Essex and Franklin County IDAs and NBT developed a plan that would enable Ward Lumber I to survive and continue its employment, including a staged upgrade of the facility. According to the statement:

> ESDC proposed economic development benefits to assist with the re-tooling of the facility, including a grant for the acquisition of a band saw and certain Empire Zone benefits. These Empire Zone benefits would provide needed cash flow to convince forbearance by the bank and additional lending by the bank. In order to remain in business, the business needed an extension of credit from the bank in the approximate amount of $500,000 to maintain working capital. The bank was willing to lend this money in the event that additional cash flow was made available by reason of the merger into Ward Lumber Company, Inc. Because of the merger into Ward Lumber Company, Inc., and in reliance on ESDC's recommendations, the bank extended an additional $500,000 on a line of credit to keep the business operating, helped finance (together with an ESDC grant) the acquisition of the band saw, and financed subsequent upgrades. These improvements have increased the facility's yield by 12% and have allowed the facility to remain in operation. Without the merger, these funds would not have been available and the business would have shut down.
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> Based upon this recommended course of action from ESDC, the use of a merger into a new corporation was examined by the business. At that time, the business was in the midst of succession planning. Because of the advantages of Delaware law with respect to management, franchise taxes and the elimination of certain liabilities if a merger into a Delaware corporation occurred, a decision was made to merge the Predecessor Corporation [Ward Lumber I], a New York corporation, into a new Delaware corporation, Ward Lumber Company, Inc. [petitioner]. Delaware law afforded a better legal structure for the relationship of the shareholders and management through a transition in ownership and management personnel, and allowed for the isolation of certain liabilities.
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> Because of the merger into Ward Lumber Company, Inc. [petitioner], the business has returned to modest profitability, avoided a shutdown and liquidation by its lender, and maintained its employment of over 100 employees. Ward Lumber Company, Inc. [petitioner], was formed, based upon advice and guidance from ESDC, to reassure the bank of the future prospects of the business, provide additional cash flow available to a lender, and to obtain needed funds from the bank for an upgrade of the facilities. Ward Lumber Company, Inc. [petitioner] was not formed solely to obtain Empire Zone benefits.

The Schedule G Statement was signed by Jay Ward.

17. Following an audit, the Division of Taxation (Division) denied petitioner certain QEZE tax benefits beginning in 2005 on the basis that petitioner did not have a valid business purpose. Specifically, by letter dated May 8, 2008, the Division disallowed $61,720.00 in QEZE real property tax credits and QEZE tax reduction credits claimed by petitioner in 2005 and $70,040.00 in QEZE real property tax credits and QEZE tax reduction credits claimed by petitioner in 2006. In addition, by letter dated April 14, 2009, the Division disallowed $65,819.00 in QEZE real property tax credits and QEZE tax reduction credits claimed by petitioner in 2007.

18. On April 28, 2011, the administrative law judge issued his determination that Tax Law § 14(j)(4)(B) presents a two-fold test requiring an entity claiming Empire Zone tax credits to establish it was formed for a valid business purpose (Tax Law § 208[9][o][1][D]) and that its formation was not motivated solely to acquire Empire Zone benefits. The administrative law judge further determined that petitioner was in a serious financial situation in 2001 and needed forbearance and credit from its bank, NBT, in order to survive and that petitioner reorganized solely for Empire Zone benefits, because such benefits were used to induce NBT to extend additional credit to petitioner. The administrative law judge concluded that petitioner could not be considered a new business because it failed the test under Tax Law § 14(j)(4)(B), as it did not have a non-tax primary motivation for its reorganization.

19. On July 10, 2012, the Tax Appeals Tribunal issued its decision that Tax Law § 14(j)(4)(B) presents a two-fold test requiring an entity claiming Empire Zone tax credits to establish it was formed for a valid business purpose (Tax Law § 208[9][o][1][D]) and that its formation was not motivated solely to acquire Empire Zone benefits. However, the Tribunal found that petitioner had met the test, finding first that the administrative law judge had erred by

viewing the reorganization in isolation rather than as part of a larger plan. The record, taken as a whole, established that the reorganization was part of a larger plan to save the business, which included the grant from the ESDC, the loan from NYSERDA and the credit extended by NBT. The primary motivation for the reorganization was the acquisition of the credit extension from NBT. According to the Tribunal, the reorganization resulted in a new entity with a new credit rating, resulting in upgrades to the business's facilities that allowed it to improve efficiency, enter new markets and save jobs. In conclusion, the Tribunal emphasized that petitioner, by creating a new business that saved a significant number of jobs in a specified region, had directly met the purpose of the Empire Zones Program to stimulate investment and job creation. Under these circumstances, it found "the position of the Division and the pursuit of this case by its Audit Department to be inappropriate. . . ."

20. Petitioner's August 9, 2012 application for costs seeks an award of costs in the amount of $45,445.17, consisting specifically of the following items:

a) $1,909.37 for disbursements.

b) $43,535.80 for legal fees billed by the law firm of Hiscock & Barclay, LLP (H & B).

21. Accompanying petitioner's application for costs were invoices submitted by H & B to petitioner for legal services performed with regard to the Division's denial of the claimed Empire Zone benefits. The invoices indicate hourly rates of $145.00, $195.00 and $340.00 for three H & B attorneys, and an hourly rate of $225.00 for H & B's project development specialist. An affidavit states that an award of attorney's fees at a rate higher than $75.00 per hour is warranted due to the market rates in New York for attorneys with the experience level possessed by H & B's attorneys in Empire Zone matters, tax matters and commercial litigation matters.

22. Also accompanying petitioner's application for costs was petitioner's 2009 franchise tax return that indicated Ward Lumber had approximately 75 employees in 2005 and petitioner's financial statement, dated December 31, 2009, that indicated the net worth of the company was $2,502,330.00.

23. In opposition to petitioner's application, the Division maintains that its position in proceeding with this matter, i.e., (1) that Tax Law § 14(j)(4)(B) requires an entity to establish that it was formed for a valid business purpose and that its formation was not motivated solely to acquire Empire Zone benefits and (2) that the facts established that petitioner was formed solely to obtain QEZE tax benefits, was substantially justified.

The Division further asserts that the costs and expenses sought to be recovered are unauthorized and unreasonable. Specifically, the Division asserts that petitioner has failed to present any exceptional circumstances for an hourly rate in excess of $75.00, as required by Tax Law § 3030(c)(1)(B)(iii), and that no expert testified at hearing, as required for reimbursement by Tax Law § 3030(c)(5)(A)(ii).

CONCLUSIONS OF LAW

A. Tax Law § 3030(a) provides, generally, as follows:

> In any administrative or court proceeding which is brought by or against the commissioner in connection with the determination, collection, or refund of any tax, the prevailing party may be awarded a judgment or a settlement for:
>
> (1) reasonable administrative costs incurred in connection with such administrative proceeding within the department, and
>
> (2) reasonable litigation costs incurred in connection with such court proceeding.

Reasonable administrative costs include reasonable fees paid in connection with the administrative proceeding, but incurred after the issuance of the notice or other document giving

rise to the taxpayer's right to a hearing. (Tax Law § 3030[c][2][B].) Such costs include reasonable fees for the services of attorneys in connection with the administrative proceeding, "except that such fees shall not be in excess of seventy-five dollars per hour unless the [Division of Tax Appeals] determines that an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys for such proceeding, justifies a higher rate" (Tax Law § 3030[c][1][B][iii]; ***see also*** Tax Law § 3030[c][2][B]).

B. A prevailing party is defined by the statute as follows:

> [A]ny party in any proceeding to which [Tax Law § 3030(a)] applies (other than the commissioner or any creditor of the taxpayer involved):
>
> (i) who (I) has substantially prevailed with respect to the amount in controversy, or (II) has substantially prevailed with respect to the most significant issue or set of issues presented, and
>
> (ii) who (I) within thirty days of final judgment in the action, submits to the court an application for fees and other expenses which shows that the party is a prevailing party and is eligible to receive an award under this section, and the amount sought, including an itemized statement from an attorney or expert witness representing or appearing in behalf of the party stating the actual time expended and the rate at which fees and other expenses were computed . . . and (II) is . . . any . . . corporation . . . the net worth of which did not exceed seven million dollars at the time the civil action was filed . . . .
>
> (B) Exception if the commissioner establishes that the commissioner's position was substantially justified.
>
> (i) General rule. A party shall not be treated as the prevailing party in a proceeding to which [Tax Law § 3030(a)] of this section applies if the commissioner establishes that the position of the commissioner in the proceeding was substantially justified.
>
> (ii) Burden of proof. The commissioner shall have the burden of proof of establishing that the commissioner's position in a proceeding referred to in subdivision (a) of this section was substantially justified, in which event, a party shall not be treated as a prevailing party.
>
> (iii) Presumption. For purposes of clause (i) of this subparagraph, the position of the commissioner shall be presumed not to be substantially justified if the

> department, inter alia, did not follow its applicable published guidance in the administrative proceeding. Such presumption may be rebutted.
>
> (iv) Applicable published guidance. For purposes of clause (ii) of this subparagraph, the term "applicable published guidance" means (I) regulations, declaratory rulings, information releases, notices, announcements, and technical services bureau memoranda, and (II) any of the following which are issued to the taxpayer: advisory opinions and opinions of counsel.
>
> (C) Determination as to prevailing party. Any determination under this paragraph as to whether a party is a prevailing party shall be made by agreement of the parties or (i) in the case where the final determination with respect to tax is made at the administrative level, by the division of tax appeals, or (ii) in the case where such final determination is made by a court, the court (Tax Law § 3030[c][5]).

C. In order to be granted an award of costs, it must be determined that the taxpayer is the "prevailing party" pursuant to Tax Law § 3030(c)(5)(A). Furthermore, any such grant is subject to the limitation of Tax Law § 3030(c)(5)(B), which provides that a taxpayer may not be treated as a prevailing party, and thus may not be awarded costs, if the Division establishes that its position was "substantially justified." Clearly, petitioner has satisfied all the criteria of being the "prevailing party" in this matter per Tax Law § 3030(c)(5)(A)(i), inasmuch as it substantially prevailed on the most significant issue presented, that it had properly claimed Empire Zone benefits, as it established a valid business purpose for restructuring its business other than to obtain tax credits. Thus, the critical remaining question is whether the Division's position was "substantially justified" (Tax Law § 3030[c][5][B]), for if it was, then petitioner may not be treated as a prevailing party and is ineligible for an award of costs and fees.

D. Tax Law § 3030 is clearly modeled after Internal Revenue Code § 7430. It is proper, therefore, to use Federal cases for guidance in analyzing this State law (***see Matter of Levin v. Gallman***, 42 NY2d 32, 396 NYS2d 623 [1977]; ***Matter of Ilter Sener***, Tax Appeals Tribunal, May 5, 1988). A position is substantially justified if it has a reasonable basis in both fact and law

(***see Information Resources, Inc. v. United States***, 996 F2d 780, 785, 93-2 US Tax Cas ¶ 50,519 [1993]), with such determination properly based "on all the facts and circumstances surrounding the case, not solely upon the final outcome" (***Matter of Stuckless,*** Tax Appeals Tribunal, August 16, 2007, citing ***Heasley v. Commissioner***, 967 F2d 116, 120, 92 US Tax Cas ¶ 50,412 [1992]; ***Phillips v. Commissioner***, 851 F2d 1492, 1499, 88-2 US Tax Cas ¶ 9431 [1988]). This determination of "substantially justified" is properly made in view of what the Division knew at the time the position was taken, i.e., when the notice was issued (Tax Law § 3030[c][8][B]; ***see DeVenney v. Commissioner***, 85 TC 927, 930 [1985]). The fact that the notice was cancelled, or, as in this case, the Empire Zone benefits were determined to have been properly claimed, is a factor to be considered. However, this action does not preclude a finding that the Division's position was substantially justified at the time the notice was issued (***see Heasley v. Commissioner***).

E. The Division's position is substantially justified where it pursues litigation in close legal questions presented on novel issues (***Spriggs v. United States***, 660 F Supp 789, 87-2 US Tax Cas ¶ 9392 [1987], ***affd*** 850 F2d 690 [1988]; ***United States v. Wilkinson***, 628 F Supp 29, 85-2 US Tax Cas ¶ 9825 [1985]). The issues in this matter as to the appropriate test to apply when determining whether an entity satisfies the requirements of Tax Law § 14(j)(4)(B) and the factors to consider in making such a determination had not been fully addressed by the Tax Appeals Tribunal until its decisions in ***Matter of Graphite Metallizing Holdings, Inc.*** (Tax Appeals Tribunal, July 7, 2011), ***Matter of Dunk & Bright Furniture Co., Inc***. (Tax Appeals Tribunal, June 28, 2012) and the present matter. All were decided after the Division had issued its denial letters to petitioner concerning the years at issue. Clearly, the Division is entitled to seek judicial guidance in situations where, as here, the statute gives little direction, is open to

several interpretations or where the issue or issues are one of first impression (***Blanco Investments & Land, LTD v. Commissioner***, 55 TCM 677 [1988]). It is clear that the Division's position was substantially justified.

F. Since a determination has been made that the Division was substantially justified in its position, and thus, petitioner is not entitled to an award of costs, it is unnecessary to determine whether the costs claimed are reasonable or appropriate.

G. The application for costs of Ward Lumber Co., Inc., is denied.

DATED: Albany, New York
December 13, 2012

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE