STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ANGELO AND ELENA BALBO	:	DECISION DTA NOS. 825765
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2011 and 2012.	:	AND 826269

Petitioners, Angelo and Elena Balbo, filed an exception to the determination of the Administrative Law Judge issued on August 27, 2015. Petitioner appeared by Barclay Damon LLP (David G. Burch, Jr., Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument was heard in Albany, New York on February 25, 2016, which date began the six-month period for the issuance of this decision.

After reviewing the entire record, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether payments by a qualified empire zone enterprise (QEZE) that is a lessee of real property to an escrow account established for the payment of real property taxes pursuant to a loan agreement between the lessor-borrower and the lender constitute eligible real property taxes for purposes of the QEZE credit for real property taxes under Tax Law § 15 (e).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for findings of fact 2, 5, 6, 7 and 8, which we have modified to more fully reflect the record. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

1. Angelo Balbo is the sole shareholder of Angelo Balbo Realty Corp. (Balbo Realty or Realty). Balbo Realty is a New York corporation that elected to be taxed under subchapter S of the Internal Revenue Code.

2. Angelo Balbo Management LLC (Balbo Management or Management) is a New York limited liability company whose sole member is Angelo Balbo. Since July 30, 2002, Balbo Management has been certified under Article 18-B of the General Municipal Law in the Poughkeepsie/Dutchess Empire Zone at various locations, including a parcel located at 9-11 Raymond Avenue, Poughkeepsie, New York (the Property).

3. Balbo Management entered into a lease agreement commencing on January 1, 2008, whereby Balbo Realty, as landlord, leased the Property to Balbo Management, as tenant (Original Lease Agreement). The Original Lease Agreement provided that the tenant would pay the landlord the amount due on the tax bills. Subsequently, Balbo Realty and Balbo Management entered into a Revised Lease Agreement, dated November 1, 2009, which required Balbo Management to make payment of all state, county, city and school taxes directly to the taxing authority. The Revised Lease Agreement was in effect during the audit period.

4. Previously, Balbo Realty, as borrower, entered into a Loan Agreement, dated March 14, 2007, with IXIS Real Estate Capital Inc. (the Lender) with respect to the Property (Loan Agreement). Angelo Balbo executed the Loan Agreement as the managing member of Balbo Management and sole shareholder of Balbo Realty. The Loan Agreement required Balbo Realty

to make monthly payments to the Lender. The amounts were to be deposited into an escrow account, known as the Tax and Insurance Subaccount. Wells Fargo was the Lender's servicing agent and the amounts were held for payment to the taxing authority of all real estate taxes on the Property.

5. Balbo Management made payments to the Lender for deposit into the Tax and Insurance Subaccount, and the Lender made payments of the real property taxes from the subaccount to the appropriate taxing jurisdictions.[1]

6. Petitioners filed joint New York State income tax returns for the years 2011 and 2012. On each return, petitioners claimed tax credits arising from Balbo Management's certification as an empire zone enterprise. One of the credits claimed was the QEZE credit for real property taxes. Balbo Management determined the amount of QEZE credit on property owned by Balbo Management and on property leased by Balbo Management, including the Property. In order to calculate the amount of the credit, petitioners relied in part upon the property tax bills from the Town of Poughkeepsie and Dutchess County for the 2011 and 2012 calendar years and Poughkeepsie school tax bills for the fiscal years ended June 30, 2012 and June 30, 2013, less any special assessments. Receipts issued by taxing authorities for real property taxes paid on the Property were issued in the name of Balbo Realty.

7. On audit, the Division reduced the amount of the refund allowed for 2011 and 2012 on the basis that Balbo Management, as a lessee, made payments to Balbo Realty's tax escrow account rather than directly to the taxing jurisdictions. The Division reached this conclusion following a review of the canceled checks payable to the escrow account, an examination of

[1] The checks from Balbo Management were made payable to Wells Fargo.

schedule E of petitioners' income tax returns and schedule 8825 (rental real estate income and expenses of a partnership or an S corporation) pertaining to Balbo Realty.

8. On the basis of the foregoing, the Division issued to petitioners an account adjustment notice, dated November 1, 2012, advising that their claimed refund of $240,126.00 for the year 2011 was reduced to $99,465.04. Similarly, on April 4, 2014, the Division issued to petitioners an account adjustment notice advising that their claimed refund of $241,103.00 for the year 2012 was reduced to $86,850.48. These partial disallowances of petitioners' claimed refunds for 2011 and 2012 were based on the Division's audit determination that Balbo Management's payments into Balbo Realty's escrow account as described herein did not qualify as payments of eligible real property taxes for purposes of the QEZE real property tax credit and that, therefore, petitioners' claims for refund of such credit must be denied.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge observed that Tax Law § 15 (e) allows a QEZE credit for real property taxes paid where the QEZE is a lessee of real property when certain conditions are satisfied. He found, however, that petitioners failed to meet one of the conditions. Specifically, the Administrative Law Judge determined that Balbo Management, the QEZE-lessee, did not pay the subject real property taxes *directly* to the taxing authority as required under Tax Law § 15 (e) in order to qualify for the credit. He thus rejected petitioners' claim that Balbo Management's payments to the escrow account satisfied this requirement. The Administrative Law Judge acknowledged the apparent inequitable outcome in the present matter, but concluded that the explicit language of the statute required such a result. Accordingly, the Administrative Law Judge sustained the Division's disallowance of petitioners' claims for refund.

ARGUMENTS ON EXCEPTION

Petitioners continue to argue that, under the facts and circumstances herein, Balbo Management's payments to the escrow account satisfy the direct payment requirement of Tax Law § 15 (e) (3). Petitioners note that Management was obligated to make property tax payments directly to the taxing authority under the Revised Lease Agreement. They assert that Management fulfilled that obligation by making payments to the escrow account as required by the Loan Agreement. Petitioners note that the escrow account was established specifically for the payment of real property taxes to the appropriate taxing authority. Petitioners contend that the Lender had a statutory responsibility to pay funds deposited in the escrow account to the appropriate taxing authority when the taxes were due. Petitioners thus argue that Management's payments to the escrow account meet the statutory definition of eligible real property taxes under Tax Law § 15 (e).

The Division continues to assert that the property tax payment arrangement herein did not meet the direct payment condition set forth in the statute because the payments were made to the escrow account and not directly to the taxing authority as required where the QEZE is a lessee.

The Division notes that the escrow account was established pursuant to the Loan Agreement between the Lender and Realty, not Management. The Division states that, had the escrow account been for the benefit of Management, it would have allowed the credit claims at issue. The Division also distinguishes the instant circumstances from the more typical situation where property taxes are paid from an escrow account funded by the borrower-mortgagor. According to the Division, assuming said borrower-mortgagor was a QEZE, such payments would qualify for the subject credit.

In response, petitioners argue that the distinctions drawn by the Division are arbitrary and unreasonable. Petitioners note that petitioner Angelo Balbo is the sole owner of both Balbo Management and Balbo Realty. They note further that Management executed the Loan Agreement on behalf of Realty as its sole shareholder. Given this affiliated relationship, petitioners assert that the escrow account was for Management's benefit and thus any payments to the escrow account were made directly to the taxing authority.

Petitioners contend that the direct payment requirement was enacted to prevent both an owner and a tenant from claiming QEZE real property tax credits. As that issue is not present in this case, the disallowance of the claimed credit is inconsistent with the intent of the Legislature. On the contrary, petitioners assert, the granting of the claimed credit is consistent with the legislative intent underlying Tax Law § 15 (e) to provide a tax benefit to QEZE-tenants for job creation and investment.

OPINION

We affirm the determination of the Administrative Law Judge.

The Legislature enacted the empire zones program to spur economic growth and job creation (***see*** General Municipal Law § 956; ***Matter of Solis-Cohen***, Tax Appeals Tribunal, March 3, 2016).[2] Among various tax benefits under the program, Tax Law § 15, together with Tax Law § 606 (bb), provides a tax credit for eligible real property taxes to an individual taxpayer who is a sole proprietor of a QEZE. Petitioner claimed the subject credit as the sole proprietor of Balbo Management.[3]

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[2] Although the program expired on July 1, 2010, a business enterprise certified pursuant to article 18-B of the General Municipal Law as of June 30, 2010 may continue to claim QEZE real property tax credits for the remainder of its tax benefit period so long as it meets the relevant statutory requirements (***see*** Tax Law § 14 [k]; L 2009, c 57).

[3] As a single-member LLC, Balbo Management was a disregarded entity and thus treated as a sole proprietorship for income tax reporting purposes. There is no dispute that Management was a QEZE as defined in Tax Law § 14 (a).

Where, as here, the QEZE credit for real property taxes is claimed by a QEZE that is a lessee of the real property, the following conditions must be satisfied in order for the payments to be considered eligible real property taxes and thus qualify for the credit:

> "(1) the taxes must be paid by the lessee pursuant to explicit requirements in a written lease executed or amended on or after June first, two thousand five, (2) such taxes become a lien on the real property during a taxable year in which the lessee of the real property is both certified pursuant to article eighteen-B of the general municipal law and a qualified empire zone enterprise, and (3) *the lessee has made direct payment of such taxes to the taxing authority* and has received a receipt for such payment of taxes from the taxing authority" (Tax Law § 15 [e]; emphasis added).

The narrow subject of the dispute in the present matter is whether Management's payments to Realty's escrow account as described herein were direct payments of taxes to the taxing authority within the meaning of Tax Law § 15 (e).[4] Resolution of this question is a matter of statutory interpretation, the purpose of which is to ascertain and give effect to the intent of the Legislature (***Patrolmen's Benevolent Assn. of City of N.Y. v City of New York***, 41 NY2d 205 [1976] ***citing Matter of Petterson v Daystrom Corp.***, 17 NY2d 32 [1966]). The language of the statute is the clearest evidence of such intent (McKinney's Cons Laws of NY, Book 1, Statutes § 51 [d]). Where no ambiguity exists, "the court should construe it so as to give effect to the plain meaning of the words used" (***Patrolmen's Benevolent Assn. of City of N.Y.*** 41 NY2d at 208). Ultimately, proper statutory construction focuses on "the precise language of the enactment in an effort to give a correct, fair and practical construction that properly accords with the discernable intention and expression of the Legislature [citation omitted]" (***Matter of 1605 Book Ctr. v Tax Appeals Trib. of State of N.Y.***, 83 NY2d 240, 244, 245 [1994], ***cert denied*** 513 US 811 [1994]).

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[4] There is no dispute that Management's payments satisfied the first two conditions to be considered eligible real property taxes as set forth above.

With respect to tax credit statutes in particular, we note that such provisions are similar to, and should be construed in the same manner as, statutes creating tax exemptions (***see Matter of Piccolo v New York State Tax Appeals Trib***., 108 AD3d 107 [2013]). That is, such statutes must be strictly construed against the taxpayer (***see e.g. Matter of 677 New Loudon Corp. v State of NY. Tax Appeals Trib.***, 19 NY3d 1058 [2012], ***cert denied*** 134 S Ct 422 [2013]). Petitioner has the burden to establish "a clearcut entitlement" to the statutory benefit (***Matter of Golub Serv. Sta. v Tax Appeals Trib. of State of N.Y.***, 181 AD2d 216, 219 [1992]). Indeed, petitioner must prove that the Division's interpretation is irrational and that its interpretation of the statute is the only reasonable construction (***Matter of Brooklyn Navy Yard Cogeneration Partners, L.P. v Tax Appeals Trib. of State of N.Y.***, 46 AD3d 1247 [2007], ***lv denied*** 10 NY3d 706 [2008]). Nevertheless, construction of an exemption or credit statute should not be so narrow as to defeat the provision's settled purpose (***Matter of Grace v New York State Tax Commn.***, 37 NY2d 193, 196 [1975], ***rearg denied*** 37 NY2d 816 [1976], ***lv denied*** 338 NE2d 330 [1975]).

In the context of Tax Law § 15 (e), "direct payment" means "[a] payment made directly to the payee, without using an intermediary" (Black's Law Dictionary 1244 [9th ed 2009]; ***see also*** Random House Webster's College Dictionary 371 [2nd ed 1997] ["direct" means "without intermediary agents, conditions, etc."]). Although Management's payments were ultimately used to pay real property taxes on the property to the appropriate taxing authorities, such payments made through an intermediary, Wells Fargo, via Realty's escrow account. Such payments were not, therefore, direct payments as required for a lessee to qualify for the subject credit.

We find support for our statutory interpretation by the contrasting absence of any direct payment requirement where the QEZE real property tax credit is claimed by a QEZE-owner of the real property. Under such circumstances, the statute requires only that the taxes be "paid by

the QEZE which is the owner" in order to be eligible for the credit (Tax Law § 15 [e]).[5] In our view, if the Legislature intended for QEZE-lessees to qualify for the credit at issue by making indirect payments of real property taxes, such as the payments made by Management herein, it would have used language similar to that employed with respect to QEZE-owners.

Petitioners' proposed construction of Tax Law § 15 (e) would read the direct payment requirement for QEZE-lessees out of the statute and thereby treat QEZE-lessees the same as QEZE-owners. We reject this construction, for "[w]e cannot, under long settled principles of statutory interpretation, essentially rewrite an unambiguous provision of a statute by ignoring explicit language, no matter how equitable such a result may appear (citations omitted)" (***Matter of The Golub Corp. v New York State Tax Appeals Tribunal*** (116 AD3d 1261, 1263 [2014]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Angelo and Elena Balbo is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Angelo and Elena Balbo are denied; and

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[5] Tax Law § 15 (e) also includes within the definition of eligible real property taxes for a QEZE-owner taxes paid by a tenant "which cannot treat such payment as eligible real property taxes pursuant to this paragraph." As discussed, Management's payments may not be treated as eligible real property taxes. Unfortunately for petitioners, however, Realty is apparently not a QEZE. Hence, although this provision offers no relief to petitioners, it does show that the Legislature was aware that a QEZE-lessee's payment of real property taxes might fail to qualify as eligible real property taxes under the strict definition set forth in the statute and, under such circumstances, allowed a QEZE-owner to claim such credit, notwithstanding that the taxes were paid by the lessee. This provision thus provides further support for this decision's adherence to the precise statutory language.

4. The account adjustment notices, dated November 1, 2012 and April 4, 2014, are sustained.

DATED: Albany, New York
August 18, 2016

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner