STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions :

of :

THOMAS A. AND DOREEN WENDT, : DETERMINATION
THOMAS A. WENDT, JR., DTA NOS. 824856,
MICHAEL D. WOODWARD, : 824857, 824858,
AND JOSEPH BERTOZZI 824859

:

for Redetermination of Deficiencies or for Refund of
Personal Income Tax under Article 22 of the Tax Law :
for the Years 2009 and 2010.

:

Petitioners, Thomas A. and Doreen Wendt, Thomas A. Wendt, Jr., Michael D. Woodward and Joseph Bertozzi, filed petitions for redetermination of deficiencies or for refund of personal income tax under article 22 of the Tax Law for the years 2009 and 2010.

On June 14, 2013, petitioners, appearing by Harris Beach, PLLC (Pietra G. Lettieri, Esq., of counsel), and on July 2, 2013, the Division of Taxation, appearing by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by May 6, 2014, which date began the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Donna M. Gardiner, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly calculated the income of a Qualified Empire

Zone Enterprise (QEZE) S corporation in the tax factor portion of the Tax Reduction Credit under Tax Law § 16.

FINDINGS OF FACT

1. Petitioners were, at all relevant times, shareholders of Wendt Corporation (corporation), a New York corporation that elected, effective March 14, 1990, to be taxed as a subchapter S corporation in accordance with the Internal Revenue Code (IRC) and the New York State Tax Law.

2. During the periods at issue, the corporation was located at, had a mailing address of, and operated at 2080 Military Road, Tonawanda, New York 14150.

3. The corporation is a designer and manufacturer of systems utilized to recycle commodities. In 1949, Wilfred Wendt co-founded D&J Press Company, Inc., which manufactured hydraulic bailing presses for the scrap processing industry. After working closely with his father for a number of years, Thomas A. Wendt, Sr. continued the family commitment to the industry by forming the corporation in 1977. Through the years, the corporation developed specialized products and strategic partnerships with world-class providers of complimenting products and services in the scrap processing equipment industry. The corporation's portfolio of advanced shredding and separation system installations is unmatched in North America.

4. As an S corporation, all of the corporation's income, loss, deductions and credits flow through to its shareholders pursuant to IRC § 1366 and Tax Law § 660. During the audit period, petitioners held the corresponding ownership interests in the corporation as follows:

Shareholder	Percentage of Ownership
Thomas A. Wendt, Sr.	87.9630%

Thomas A. Wendt, Jr.	6.4815%
Joseph Bertozzi	2.7778%
Michael D. Woodward	2.7778%
TOTAL	100.000%

5. During the audit period, the shareholders of the corporation received the flow-through benefit of the QEZE tax credits claimed, including the QEZE Tax Reduction Credit (TRC), allocated pro-rata in accordance with their ownership interests.

6. The corporation was certified as a QEZE as of February 23, 2004 in connection with its facility located at 2080 Military Road, Tonawanda, New York 14150. The corporation subsequently qualified to receive its Empire Zone Retention Certificate, effective as of the same date.

7. During the audit years, the corporation's manufacturing of advance shredding and separation systems took place in its facility located at 2080 Military Road, located 100% within the Zone.

8. The corporation filed New York S corporation franchise tax returns pursuant to Article 9-A of the Tax Law for both 2009 and 2010.

9. As New York residents, petitioners received schedules K-1s from the corporation for the years 2009 and 2010, providing the amount of income from the corporation to be allocated to each of petitioners' returns. Petitioners each timely filed their New York State resident income tax returns for 2009 and 2010 and claimed their respective proportional shares of the corporation's QEZE tax credits, including the QEZE TRC, pursuant to Tax Law § 606(i)(1)(B).

10. On each of petitioners' personal income tax returns, petitioners claimed their pro-rata share of the QEZE TRC, calculated on form IT-604. The TRC was calculated by applying a four-factor formula consisting of the product of the benefit period factor, the employment increase factor, the zone allocation factor and the tax factor. The tax factor calculated for each of petitioners' respective claims for the QEZE TRC was calculated as the product of each of petitioners' incomes from the corporation allocated within New York, divided by each of petitioners' New York State adjusted gross incomes (AGI), multiplied by each of petitioners' New York State income tax.

11. Petitioners' New York State resident income tax returns for 2009 and 2010 were audited by the Division of Taxation (Division) for the purpose of, among other things, reviewing petitioners' claims for the QEZE TRC. The Division determined that petitioners incorrectly calculated the TRC claimed based upon their ownership of the corporation. The Division determined that petitioners used the corporation's aggregate income from all sources in calculating the tax factor under Tax Law § 16. The Division concluded that only the corporation's New York source income should be used, which it defined as the corporation's income reported on petitioners' K-1s, multiplied by the corporation's business allocation percentage (BAP) as reported on the corporation's franchise tax returns for 2009 and 2010.

12. Based upon the Division's finding regarding the calculation of the tax factor, it issued two notices of deficiency dated November 4, 2011 to each of the four petitioners for the years 2009 and 2010. Notices of deficiency L-036866955 and L-036866951 were issued to Thomas A. Wendt, Sr. for the years 2009 and 2010, respectively. Notices of deficiency L-036866958 and

L-036866952 were issued to Thomas A. Wendt, Jr., for the tax years 2009 and 2010, respectively. Notices of deficiency L-036866956 and L-036866954 were issued to Michael D. Woodward for the tax years 2009 and 2010, respectively. Notices of deficiency L-036866953 and L-036866957 were issued to Joseph Bertozzi for the tax years 2009 and 2010, respectively. The notices issued adjusted the TRC claimed by petitioners since the Division determined that the tax factor included income in excess of the corporation's New York source income.

13. On February 2, 2012, petitioners filed timely petitions contesting the above-described notices.

14. On February 27, 2012, the Division issued two notices and demands to each of petitioners, which substantially reduced all of the assessments. All eight of the notices and demands have identical assessment numbers to the eight notices of deficiency set forth in Finding of Fact 12. However, none of the notices and demands explain the revised tax amount set forth therein.

CONCLUSIONS OF LAW

A. Chapter 63 of the Laws of 2000 amended the Tax Law to provide benefits under the Empire Zones Program Act, amending articles 9-A, 22, 32 and 33 of the Tax Law to provide new tax credits, which applied to taxable years beginning on or after January 1, 2001. The Act included Tax Law § 16, which provides for the QEZE tax reduction credit against corporate and personal income taxes of a QEZE and shareholders of New York S corporations that are QEZEs.

B. Tax Law § 16(b) provides that the mount of the tax reduction credit "shall be the product of (i) the benefit period factor, (ii) the employment increase factor, (iii) the zone

allocation factor and (iv) the tax factor." The calculations of the first three factors are not in dispute.

C. The focus of this case devolves to the calculation of the tax factor in determining the TRC for a QEZE S corporation. Tax Law § 16(f)(2)(C) provides the following with respect to the determination of the tax factor for shareholders of an S corporation, such as petitioners:

> Where the taxpayer is a shareholder of a New York S corporation which is a qualified empire zone enterprise, the shareholder's tax factor shall be that portion of the amount determined in paragraph one of this subdivision which is attributable to the income of the S corporation. Such attribution shall be made in accordance with the ratio of the shareholder's income from the S corporation allocated within the state, entering into New York adjusted gross income, to the shareholder's New York adjusted gross income, or in accordance with such other methods as the commissioner may prescribe as providing an apportionment which reasonably reflects the portion of the shareholder's tax attributable to the income of the qualified empire zone enterprise. In no event may the ratio so determined exceed 1.0.

D. Tax Law § 16(f)(1) states that:

> The tax factor shall be, in the case of article nine-A of this chapter, the larger of the amounts of tax determined for the taxable year under paragraphs (a) and (c) of subdivision one of section two hundred ten of such article. The tax factor shall be, in the case of article twenty-two of this chapter, the tax determined for the taxable year under subsections (a) through (d) of section six hundred one of such article.

E. Petitioners herein were shareholders of the Wendt corporation, a subchapter S corporation and a QEZE. As an S corporation, all of Wendt's income, loss, deductions and credits flow through to petitioners pursuant to IRC § 1366 and Tax Law § 660. Therefore, petitioners' New York State tax on income attributable to Wendt is computed pursuant to Article 22 and not Article 9-A. However, it is the Division's position that it is appropriate to apply Article 9-A principles discussed in the first sentence of Tax Law § 16(f)(1) to Article 22

taxpayers.

F. A tax credit is a particularized species of exemption from tax (***Matter of New York Fuel Terminal Corp.***, Tax Appeals Tribunal, August 27, 1998). Statutes creating exemptions from tax are to be strictly construed (***see Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193 [1975], ***lv denied*** 37 NY2d 708 [1975]; ***Matter of Blue Spruce Farms v. New York State Tax Commn.***, 99 AD2d 867 [1984], ***affd*** 64 NY2d 682 [1984]). Statutory rules of construction provide that the legislative intent is to be ascertained from the words and by an agency charged with its enforcement is entitled to great weight to the extent that its interpretation relies on its special competence. Where the statute is clear, the courts must follow the plain meaning of its words, and "there is no occasion for examination into extrinsic evidence to discover legislative intent . . ." (McKinney's Cons Laws of NY, Book 1, Statutes § 120; ***see Matter of Raritan Dev. Corp. v. Silva***, 91 NY2d 98 [1997]; ***Matter of Schein***, Tax Appeals Tribunal, November 6, 2003). Where, as here, words of a statute have a definite and precise meaning, it is not necessary to look elsewhere in search of conjecture so as to restrict or extend that meaning (***Matter of Erie County Agricultural Socy. v. Cluchey***, 40 NY2d 194 [1976]). As the language of the statute is clear, it is appropriate to interpret its phrases in their ordinary, everyday sense (***Matter of Automatique v. Bouchard***, 97 AD2d 183 [1983]).

G. The Division correctly asserts that it is generally recognized that the interpretation of a statute by an agency charged with its enforcement is entitled to great weight to the extent that its interpretation relies on its special competence (***Matter of Jennings v. Commissioner of Social Servs.***, 71 AD3d 98 [2010]). Moreover, "the construction given statutes and regulations by the agency responsible for their administration, if not irrational or unreasonable, should be

upheld” (***Matter of Garofolo v. Rosa***, 26 Misc 3d 969 [Sup Ct, Kings County 2009]). However, a pure legal interpretation of clear and unambiguous statutory terms requires no deference to interpretation of an agency charged with the statute’s enforcement, inasmuch as there is little or no need to rely on any special expertise on the agency’s part (***Matter of Lewis Family Farm v. New York State Adirondack Park Agency***, 64 AD3d 1009 [2009]). In fact, “[a]n administrative practice contrary to or inconsistent with the statute is without legal effect and will be disregarded by the courts” (***In re Billings’ Estate***, 70 NYS2d 191, 194 [1947]).

H. Tax Law § 16 clearly requires use of the shareholder’s portion of income from the QEZE that is allocated to New York State in calculating the tax factor. As New York State residents, all of petitioners’ income from the corporation was allocated to New York, and their tax determined under Tax Law § 601. Thus, petitioners’ tax factor was the amount of their tax that was attributable to the income from the corporation, which was as they reported for the years in issue.

I. In this case, the Division incorrectly determined that to properly calculate petitioners’ income from the QEZE allocated to New York, the QEZE’s New York source income should first be multiplied by the QEZE’s business allocation percentage (BAP). Tax Law § 16(f)(2) plainly states that when the taxpayer seeking the tax reduction credit is a shareholder of an S corporation, the shareholder’s tax factor is the portion of his tax as determined under Tax Law § 16(f)(1), which in this case was pursuant to Article 22. It is irrelevant that the S corporation is taxed under Article 9-A, because Tax Law § 16(f)(2) clearly shifts the focus to the

shareholder and his liability. Therefore, the Division's calculation of the tax factor using the QEZE's BAP was in error.

J. As noted in Finding of Fact 14, subsequent to the filing of their petitions in this matter, the Division issued to petitioners notices and demands utilizing the same assessment numbers as used in the notices of deficiency. Moreover, these notices and demands lack any written explanation as to the revised amounts set forth therein. Under the heading *Explanations and Instructions*, the notices and demands state as follows:

> An amount is due for the Tax Type indicated above. The original notice sent to you on 11/04/11 showed the detailed computation of the additional amount due. Please refer to the COMPUTATION SUMMARY SECTION for a computation of the current balance due. Recent adjustments, credits or payments may not be reflected in the current balance due.

In reviewing the Computation Summary Section, there is simply a tax amount assessed. There is no computation made or detailed. This is in stark contrast to the notices of deficiency wherein multiple pages of computations were set forth to describe how the additional tax amounts asserted were determined. The notices and demands provided no calculations and no basis whatsoever for the reduced tax amounts. The Division did not specifically address this issue in its Answers filed to the petitions. The Division merely stated at ¶ 13 in its Answers, in pertinent part, that it:

> conducted an audit and determined that petitioners were not entitled to the Qualified Empire Zone Enterprise ("QEZE") tax reduction credits claimed on their 2009 and 2010 New York State personal income tax returns as a flow through Wendt, Corporation, Inc. The credit was ultimately denied based on the fact that the petitioners' tax factor used did not reflect tax attributable to the QEZE income allocated in New York State.

With its documents submitted, the Division included an affidavit of the auditor. The auditor makes a passing reference to the notices and demands issued, in pertinent part, that states: "[a]fter the audit was completed, we went back and made a discretionary adjustment to compute the income allocated to NYS by the QEZE using a three-factor formula which included property and payroll" (Exhibit H, ¶ 5). This sentence was also set forth in the Division's brief in opposition to the petitions filed. Given that the Division failed to address this new calculation, the argument has been deemed abandoned and will not be addressed herein.

K. As petitioners' application of Tax Law § 16 is deemed correct, their alternative argument that the Division's application of the statute violates the equal protection clauses of the United States and New York State constitutions is moot.

L. The petitions of Thomas A. and Doreen Wendt, Thomas A. Wendt, Jr., Michael D. Woodward and Joseph Bertozzi are granted and the notices of deficiency dated November 4, 2011 are canceled.

DATED: Albany, New York
November 6, 2014

/s/ Donna M. Gardiner
ADMINISTRATIVE LAW JUDGE