

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition
of
ROBERT J. AND TAMMY L. LAUGHLIN
for Redetermination of Deficiencies or for Refund of New
York State Personal Income Tax under Article 22 of the Tax
Law for the Years 2015 and 2016.

:
:
: DETERMINATION
: DTA NOS. 828788 AND
: 828789

In the Matter of the Petition
of
KIRK C. AND NICOLE L. DORN
for Redetermination of a Deficiency or for Refund of New
York State Personal Income Tax under Article 22 of the Tax
Law for the Years 2015 and 2016.

Petitioners, Robert J. and Tammy L. Laughlin, filed a petition for redetermination of deficiencies or for refund of New York State personal income tax under article 22 of the Tax Law for the years 2015 and 2016.

Petitioners, Kirk C. and Nicole L. Dorn filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under article 22 of the Tax Law for the years 2015 and 2016.

A videoconferencing hearing in these consolidated matters was held before Winifred M. Maloney, via CISCO Webex on January 29, 2021, with all briefs to be submitted by August 10, 2021, which date began the six-month period for issuance of this determination. Petitioners

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).

ISSUES

I. Whether the Division of Taxation properly determined the tax benefit period for the Qualified Empire Zone Enterprise credits claimed by TMP Acquisitions Inc., the parent of two qualified S corporations that are qualified empire zone enterprises.

II. Whether the Division of Taxation correctly calculated the Qualified Empire Zone Enterprise tax reduction credit pursuant to Tax Law § 16.

FINDINGS OF FACT

1. Time Release Sciences, Inc. (TRS), located at 205 Dingens Street, Buffalo, New York, was first organized as a New York corporation on April 29, 2004. On the same date, TRS elected to be taxed as a subchapter S corporation for federal and state tax purposes. TRS manufactures and packages consumer cleaning products for a Fortune 100 company.

2. TRS was certified at 205 Dingens Street in the Buffalo Empire Zone under article 18-B of the General Municipal Law with an effective date of October 20, 2004. TRS is a qualified empire zone enterprise (QEZE).

3. TMP Technologies, Inc. (TMP Technologies) located at 1200 Northland Avenue, Buffalo, New York, was first organized as a New York corporation on September 10, 1993. TMP Technologies elected to be taxed as a subchapter S corporation for federal and state tax purposes, effective November 1, 1995. TMP Technologies develops custom liquid applicator and dispensing applicator products.

4. TMP Technologies was certified at 1200 Northland Avenue in the Buffalo Empire Zone under article 18-B of the General Municipal Law with an effective date of December 27, 2000. TMP Technologies is a QEZE.

5. TMP Acquisitions Inc. (TMP Acquisitions) is a New York corporation, first organized on September 26, 2014. It was formed to acquire corporations including TRS and TMP Technologies. TMP Acquisitions elected to be taxed as a subchapter S corporation for federal and state tax purposes on September 26, 2014.

6. On April 30, 2015, TMP Acquisitions purchased 100% of the stock of both TRS and TMP Technologies. TRS and TMP Technologies elected to treat the purchase transaction between the shareholders of the corporations and TMP Acquisitions under section 338 (h) (10) of the Internal Revenue Code (IRC).

7. TMP Acquisitions, as the parent S corporation, elected to treat TRS as a qualified subchapter S subsidiary (QSSS) and filed the Form 8869, Qualified Subchapter S Subsidiary Election (Form 8869), with the Internal Revenue Service (IRS). Subsequently, the IRS accepted TRS' QSSS election, filed by TMP Acquisitions, effective May 1, 2015. TMP Acquisitions, as the parent S corporation, elected to treat TMP Technologies as a QSSS and filed Form 8869 with the IRS. Subsequently, the IRS accepted TMP Technologies' QSSS election, filed by TMP Acquisitions, effective May 1, 2015. The IRS also accepted TMP Acquisitions' election to be treated as a parent S corporation, effective May 1, 2015.

8. As of May 1, 2015, both TRS and TMP Technologies are disregarded for tax purposes only, and all income, losses, and tax credits are reported on the corporate tax filings of TMP Acquisitions. Both TRS and TMP Technologies continue to operate as separate business enterprises, with separate locations of operations, payroll, and payroll filings.

9. TRS was required to file a short period form 1120S, U.S. Income Tax Return for an S corporation (form 1120S), and form CT-3-S, New York S Corporation Franchise Tax Return (CT-3-S NY S corporation franchise tax return), for the period November 1, 2014 through April 30, 2015. On its CT-3-S NY S corporation franchise tax return, TRS reported its business allocation percentage (BAP) as 0.0117%, i.e., sales of New York State tangible personal property of \$2,415.00 divided by all sales of tangible personal property of \$20,707,357.00, and an investment allocation of 100.0000%. As part of its CT-3-S NY S corporation franchise tax filing, TRS also claimed, among other credits, a QEZE tax reduction credit (QEZE TRC) on form CT-604, and a QEZE credit for real property taxes (QEZE RPTC) on form CT-606. As part of its claim for the QEZE TRC, TRS reported, on form CT-604, an employment increase factor of 1.0000, a zone allocation factor of 1.0000, tax year 11 of the business tax benefit period, and a benefit period factor of 0.8. On its form CT-606, TRS reported tax year 11 of the business tax benefit period, a benefit period factor of 0.8, eligible real property taxes in the amount of \$13,002.00, and a QEZE credit for real property taxes allowed in the amount of \$10,402.00. On its form CT-34-SH, New York S corporation shareholders' information schedule (form CT-34-SH), TRS reported 5 shareholders including petitioner Robert Laughlin, who was a 15% shareholder. TRS provided each shareholder with a federal schedule K-1 and a New York schedule K-1 equivalent.

10. TMP Technologies was required to file a short period form 1120S and CT-3-S NY S corporation franchise tax return for the period November 1, 2014 through April 30, 2015. On its CT-3-S NY S corporation franchise tax return, TMP Technologies reported its business allocation percentage as 8.7825%, i.e., sales of New York State tangible personal property of \$463,102.00 divided by all sales of tangible personal property of \$5,273,012.00, and an

investment allocation of 100.0000%. TMP Technologies did not claim a QEZE TRC or a QEZE RPTC on this CT-3-S NY S corporation franchise tax filing. On its form CT-34-SH, TMP Technologies reported 5 shareholders including Mr. Laughlin, who was a 15% shareholder. TMP Technologies provided each shareholder with a federal schedule K-1 and a New York schedule K-1 equivalent.

11. TMP Acquisitions filed a form 1120S and a CT-3-S NY S corporation franchise tax return for the period November 1, 2014 through October 31, 2015. On its CT-3-S NY S corporation franchise tax return, TMP Acquisitions reported, among other things, ordinary business income of \$3,020,501.00, a business allocation percentage of 2.2516%, i.e., sales of New York State tangible personal property of \$566,232.00 divided by all sales of tangible personal property of \$25,148,335.00, and an investment allocation percentage of 100.0000%. As part of its CT-3-S NY S corporation franchise tax filing, TMP Acquisitions also claimed, among other credits, a QEZE TRC on form CT-604, and a QEZE RPTC on form CT-606. On its form CT-604, TMP Acquisitions reported an employment increase factor of 1.0000, a zone allocation factor of 1.0000, tax year 12 of the business tax benefit period, and a benefit period factor of 0.6. On its form CT-606, TMP Acquisitions reported tax year 12 of the business tax benefit period, a benefit period factor of 0.6, eligible real property taxes in the amount of \$32,658.00,¹ and a QEZE credit for real property taxes allowed in the amount of \$19,595.00. Included with its claims for the QEZE tax credits were copies of the QEZE retention certificate issued to TRS and the City of Buffalo 2015–2016 real property tax and sewer rent bill for the property located at 195 Dingens Street, Buffalo, New York, assessed to TRS.

¹ The amount of \$32,658.00 represents the first half of the 2015–2016 City of Buffalo real property tax due on 195 Dingens Street, Buffalo, New York, due and paid by July 31, 2015.

12. TMP Acquisitions filed a form 1120S and a CT-3-S NY S corporation franchise tax return for the period November 1, 2015 through October 31, 2016. On its CT-3-S NY S corporation franchise tax return, TMP Acquisitions reported, among other things, ordinary business income of \$9,281,022.00, a business allocation percentage of 1.2855%, i.e., sales of New York State tangible personal property of \$688,881.00 divided by all sales of tangible personal property of \$53,590,645.00, and an investment allocation percentage of 100.0000%. As part of its CT-3-S NY S corporation franchise tax filing, TMP Acquisitions also claimed, among other credits, a QEZE TRC on form CT-604, and a QEZE RPTC on form CT-606. On its form CT-604, TMP Acquisitions reported an employment increase factor of 1.0000, a zone allocation factor of 1.0000, tax year 13 of the business tax benefit period, and a benefit period factor of 0.4. On its form CT-606, TMP Acquisitions reported tax year 13 of the business tax benefit period, a benefit period factor of 0.4, eligible real property taxes in the amount of \$88,774.00,² and a QEZE credit for real property taxes allowed in the amount of \$35,510.00. Included with its claims for the QEZE tax credits were copies of the QEZE retention certificate issued to TRS; the City of Buffalo 2015-2016 and 2016-2017 real property tax and sewer rent bills for the property located at 195 Dingens Street, assessed to TRS, and proof of payment of the same; the County of Erie Tax, tax year 2016 bill for 195 Dingens Street, and proof of payment of the same; proof of payment of City of Buffalo – Tax in the amount of \$3,508.73 by TMP Technologies on December 4, 2015; a City of Buffalo 2016-2017 real property tax and sewer rent bill for 1208 Northland Avenue, assessed to TMP Technologies, and proof of payment of the first half

² The amount of \$88,774.00 consists of a total of \$80,207.66 paid by TRS to the City of Buffalo and the County of Erie for taxes due on the property located at 195 Dingens Street, and a total of \$8,566.34 paid by TMP Technologies to the City of Buffalo and the County of Erie for taxes due on 1208 Northland Avenue.

payment of the real property tax due on said property; and the County of Erie, tax year 2016 bill for 1208 Northland Avenue, and proof of payment of the same.

13. TMP Acquisitions' two shareholders are Mr. Laughlin, who owns 66.6667%, and petitioner Kirk C. Dorn, who owns 33.3333%. For its tax years ended October 31, 2015, and October 31, 2016, TMP Acquisitions allocated to each shareholder his proportionate share of the QEZE credits to be claimed on his 2015 and 2016 personal income tax returns.

14. As a shareholder of both TRS and TMP Acquisitions, Mr. Laughlin claimed QEZE TRCs for the years 2015 and 2016. As a shareholder of TMP Acquisitions, Mr. Dorn claimed QEZE TRCs for the years 2015 and 2016. Pursuant to Tax Law § 16 (b), the TRC is the product of multiplying four factors: (i) the benefit period factor; (ii) the employment increase factor; (iii) the zone factor; and (iv) the tax factor. The fourth factor, the tax factor, is computed by shareholders on form IT-604, claim for QEZE tax reduction credit (form IT-604), which is filed with their personal income tax returns. The tax factor is the product of (i) the ratio of the shareholder's income from the QEZE from New York State sources to the shareholder's New York State adjusted gross income; and (ii) the shareholder's New York State income tax. The tax factor produces the portion of the shareholder's New York State income resulting from income from the QEZE that is allocated to New York.

15. The instructions to form IT-604 do not mention application of the BAP in describing the procedure for calculating the tax factor as part of the TRC on returns prepared for shareholders of New York S corporations that are QEZEs. Line 21 of the form IT-604 states "Enter the amount of your income from the QEZE allocated within NYS (see instructions)." The instructions for Line 21 specific to shareholders of New York S corporations that are QEZEs as set forth on the IT-604-I state as follows:

“This is the income from the New York S corporation that is a QEZE, allocable to New York State and included in New York adjusted gross income. Do not include any wages paid to you by the New York S corporation. The income allocable to New York State is the QEZE S corporation’s income from New York State sources. This amount should be provided to you by the New York S corporation. For a nonresident of New York State, this is the New York S corporation’s income from the QEZE included in the *New York State amount* column of your Form IT-203.”

Robert J. and Tammy L. Laughlin, DTA No. 828788

16. On or about September 19, 2016, petitioners, Robert J. and Tammy L. Laughlin, jointly filed a form IT-201, New York State resident income tax return (form IT-201), for tax year 2015 (Laughlin 2015 income tax return). On that income tax return, Mr. and Mrs. Laughlin claimed, among other credits, a QEZE TRC in the amount of \$220,201.00, and a QEZE RPTC in the amount of \$14,623.00. Among the numerous forms attached to the Laughlin 2015 income tax return were form IT-604, and form IT-606, claim for QEZE credit for real property taxes (form IT-606). On the form IT-604, Mr. and Mrs. Laughlin reported the qualified QEZE business as TRS, and in Schedule F – QEZE tax reduction credit, reported a tax year 11 of the business benefit period, a benefit period factor of 0.8, an employment increase factor of 1.0000, a zone allocation factor of 1.0000, a tax factor of \$336,902.00,³ and a QEZE tax reduction credit available for use of \$220,201.00. On form IT-604, Schedule G – Beneficiary’s and fiduciary’s share of QEZE income, Mr. and Mrs. Laughlin reported a total share of QEZE income in the amount of \$3,833,390.00, consisting of TRS’ QEZE income of \$1,027,530.00 and TMP Acquisitions’ QEZE income of \$2,805,860.00. On the form IT-606, Mr. and Mrs. Laughlin reported a total QEZE credit for real property taxes in the amount of \$14,623.00, consisting of

³ To compute the tax factor, Mr. and Mrs. Laughlin first divided the income from the QEZE allocated within New York State of \$3,833,390.00 by their New York adjusted gross income of \$5,007,079.00, the result of which was 0.7656. Then, they multiplied 0.7656 by their tax of \$440,050.00 and determined their tax factor to be \$336,902.00.

Mr. Laughlin's share of TRS' QEZE RPTC of \$1,560.00 and TMP Acquisitions' QEZE RPTC of \$13,063.00. After applying all claimed credits, including the QEZE TRC and the QEZE RPTC, and New York State tax withheld against the tax determined to be due, Mr. and Mrs. Laughlin claimed an overpayment of \$122,242.00 to be applied to their 2016 New York State estimated tax.

17. The Division conducted an audit of the flow-through QEZE credits, i.e., the QEZE RPTC and the QEZE TRC, claimed on the Laughlin 2015 income tax return. As part of its review of the QEZE RPTC claimed in the total amount of \$14,623.00 (*see* finding of fact 16), the Division reviewed the computation of TRS' QEZE RPTC, and determined that adjustments to the amount of eligible real property taxes allowed, and the benefit period factor were necessary. Specifically, the Division prorated the taxes paid to April 30, 2015, allowing \$4,333.95, as TRS' QEZE eligible real property taxes paid, and changing the benefit period factor to 0.6, the tax year 12 benefit period factor. After multiplying \$4,333.95 by 0.6, the Division allowed TRS' QEZE RPTC in the amount of \$2,600.37. Because Mr. Laughlin was a 15% shareholder of TRS, his share of TRS' QEZE RPTC was redetermined to be \$390.00. The Division disallowed the pass-through of the TMP Acquisitions' QEZE RPTC credit claimed by Mr. Laughlin. The reason for the disallowance was at the time the QSSS election was made on May 1, 2015, there were two QEZEs that became part of the QSSS with TMP Acquisitions as the parent company. The Division concluded that the earliest of the two eligibility dates would determine the benefit period factor used by the parent when it claimed QEZE benefits. Because TMP Technologies had an eligibility date of December 27, 2000, the year 2015 would be year 15, with no eligibility for QEZE benefits remaining.

After the Division reviewed the claimed QEZE TRC, it disallowed it in full. In recomputing the QEZE TRC, the Division applied TRS' BAP of 0.0117% to Mr. Laughlin's reported TRS QEZE income of \$1,027,530.00, reducing the amount of QEZE income allocated within New York State to \$120.00. It did not allow any income from TMP Acquisitions in the calculation of the amount of QEZE income allocated within New York State. The Division recomputed the QEZE RPTC as follows.

Form IT-604, Schedule E – Tax Factor

20.) Tax Liability	\$438,348.00
21.) Amount of QEZE income allocated within New York State	\$120.00
22.) New York Adjusted Gross Income	\$4,987,778.00
23.) Divide line 21 by line 22	-
24.) Multiply line 20 by line 23 – Tax Factor	-

Form IT-604, Schedule F – QEZE Tax Reduction Credit

25.) Benefit Period Factor – year 12	0.6
26.) Employment Increase Factor	1.0000
27.) Zone Allocation Factor	1.0000
28.) Tax Factor	-
29.) QEZE Tax Reduction Credit available for use (line 25 X 26 X 27 x 28)	-
30.) Tax Due before Credits	\$438,348.00
31.) Credits applied against tax before this credit	-
32.) Net Tax Due	\$438,348.00
33.) QEZE Tax Reduction Credit used for the current tax year	-

18. Based upon the above adjustments to the QEZE RPTC and the QEZE TRC claimed on the Laughlin 2015 income tax return, the Division determined additional tax due in the amount of \$132,275.00. In its computation of additional tax due, the Division allowed a nonrefundable investment tax credit of \$221,633.00, a refundable college tuition credit of \$800.00, and a refundable QEZE RPTC of \$390.00, and applied estimated payments of \$68,582.00 and withholdings of \$175,308.00. The Division also denied Mr. and Mrs. Laughlin's request that \$122,242.00 be applied to their 2016 estimated tax.

19. On April 13, 2017, the Division issued to Mr. and Mrs. Laughlin a notice of deficiency, assessment ID L-046241062, asserting additional tax due in the amount of \$132,275.00, plus interest, for the year 2015. The “Explanation” section of the notice provided, in pertinent part, as follows:

“This assessment is the result of adjustments made to your 2015 QEZE Real Property Tax Credit and QEZE Tax Reduction Credit. Your request that \$122,242 be applied to 2016 estimated tax is denied and you are being assessed \$132,275 of increased tax liability.

Your QEZE Real Property Tax Credit from Time Release Sciences, Inc. was reduced to \$390. Claimed eligible taxes from Time Release Sciences, Inc. were prorated to 4/30/2015 which is the last day of the entities [sic] final short period filing period prior to making the QSSS election. The benefit period factor was adjusted to year 12 with a 0.6 factor. Time Release Sciences, Inc. has an eligibility date of 10/20/2004 making the period ended 10/31/2004 year one and period ended 4/30/2015 year 12. The entity level credit allowed is \$2,600.

Reference Tax Law Section 208 1-B. ‘The term ‘QSSS’ means a corporation which is a qualified subchapter S subsidiary as defined in subparagraph (B) of paragraph three of subsection (b) of section thirteen hundred sixty-one of the internal revenue code. The term ‘exempt QSSS’ means a QSSS exempt from tax under this article as provided in paragraph (k) of subdivision nine of this section, or a QSSS described in subclause (i) of clause (B) of subparagraph two of paragraph (k) of subdivision nine of this section, wherein the parent corporation of the QSSS is subject to tax under this article, and the assets, liabilities, income and deductions of the QSSS are treated as the assets, liabilities, income and deductions of the parent corporation.

Where a QSSS is an exempt QSSS, then for all purposes under this article: (a) the assets, liabilities, income, deductions, property, payroll, receipts, capital, credits, and all other tax attributes and elements of economic activity of the QSSS shall be deemed to be those of the parent corporation.’

Also reference TSB-M-97 (6) C.

Based upon the above your QEZE Real Property Tax Credit from TMP Acquisitions, Inc. has been disallowed. When the QSSS election was made on 5/1/2015 there were two QEZE.s which became part of the QSSS with TMP Acquisitions, Inc. as the parent company. The earliest of the two eligibility dates will determine the benefit period factor used by the parent when claiming QEZE benefits. TMP Technologies, Inc. has an eligibility date of 12/27/200 making 2015 year 15 with no eligibility for QEZE benefits remaining.

Your QEZE Tax Reduction Credit was disallowed in full. Time Release Sciences, Inc. has a Business Allocation Percentage (BAP) of 0.0117%. This was applied to your QEZE income from Time Release Sciences, Inc. reducing the QEZE income to \$120. Reference Tax Appeals Tribunal Decision, DTA Number 825436, which outlines that the BAP should be used to accurately allocate the QEZE's income from the business entity in the calculation of the tax factor.

In addition, reference Tax Law Section 208 1-B. 'The term 'QSSS' means a corporation which is a qualified subchapter S subsidiary as defined in subparagraph (B) of paragraph three of subsection (b) of section thirteen hundred sixty-one of the internal revenue code. The term 'exempt QSSS' means a QSSS exempt from tax under this article as provided in paragraph (k) of subdivision nine of this section, or a QSSS described in subclause (i) of clause (B) of subparagraph two of paragraph (k) of subdivision nine of this section, wherein the parent corporation of the QSSS is subject to tax under this article, and the assets, liabilities, income and deductions of the QSSS are treated as the assets, liabilities, income and deductions of the parent corporation.

Where a QSSS is an exempt QSSS, then for all purposes under this article: (a) the assets, liabilities, income, deductions, property, payroll, receipts, capital, credits, and all other tax attributes and elements of economic activity of the QSSS shall be deemed to be those of the parent corporation.' Also reference TSB-M-97 (6) C.

Based on the above no QEZE income is allowable in the calculation of the tax factor from TMP Acquisitions, Inc. When the QSSS election was made 5/1/2015 there were two QEZE.s which became part of the QSSS with TMP Acquisitions, Inc. as the parent company. The earliest of the two eligibility dates will determine the benefit period factor used by the parent when claiming QEZE benefits. TMP Technologies, Inc. has an eligibility date of 12/27/2000 making 2015 year 15 with no eligibility for QEZE benefits remaining."

20. On or about July 17, 2017, Mr. and Mrs. Laughlin jointly filed a form IT-201 for tax year 2016 (Laughlin 2016 income tax return). On that income tax return, Mr. and Mrs. Laughlin claimed, among other credits, an investment tax credit in the amount of \$136,059.00, a QEZE TRC in the amount of \$247,276.00, and a QEZE RPTC in the amount of \$23,673.00. Among the numerous forms attached to the Laughlin 2016 income tax return were form IT-604 and form IT-606. On the form IT-604, Mr. and Mrs. Laughlin reported the qualified QEZE business as TMP Acquisitions, and in Schedule F – QEZE tax reduction credit, reported a tax year 13 of the business benefit period, a benefit period factor of 0.4, an employment increase factor of 1.0000, a

zone allocation factor of 1.0000, a tax factor of \$618,191.00,⁴ and a QEZE tax reduction credit available for use of \$247,276.00. On form IT-604, schedule G – Beneficiary’s and fiduciary’s share of QEZE income, Mr. and Mrs. Laughlin reported a total share of QEZE income in the amount of \$7,066,424.00, consisting of TMP Acquisitions’ QEZE income of \$7,066,424.00. On the form IT-606, Mr. and Laughlin reported a total QEZE credit for real property taxes in the amount of \$23,673.00, consisting of TMP Acquisitions’ share of QEZE RPTC of \$23,673.00. After applying all claimed credits, including the QEZE TRC and the QEZE RPTC, and New York State tax withheld against the tax determined to be due, Mr. and Mrs. Laughlin claimed an overpayment of \$5,265.00 to be applied to their 2017 New York State estimated tax.

21. On or about September 12, 2017, the Division began a review of Mr. and Mrs. Laughlin’s claim for “the QEZE tax reduction credit and investment tax credit for the period ending December 31, 2016.” In order to verify the credits claimed, the Division, in a letter dated September 12, 2017, requested the following additional information:

“QEZE Tax Reduction Credit

- A detailed calculation of QEZE income allocated to New York State. Please break the calculation down by income from each entity.

Investment Tax Credit

- An itemized list of property claimed for investment tax credit. Please include a description of the property and explain how it is used in the manufacturing process. In addition, please indicate where (on which line) the property is depreciated on federal form 4562.”

22. On October 23, 2017, Mr. and Mrs. Laughlin’s representative, Robert E. Pollock, CPA, responded to the Division’s request for information and provided documentation consisting

⁴ To compute the tax factor, Mr. and Mrs. Laughlin first divided the income from the QEZE allocated within New York State of \$7,066,424.00 by their New York adjusted gross income of \$7,315,159.00, the result of which was 0.9660. Then, they multiplied 0.9660 by their tax of \$639,949.00 and determined their tax factor to be \$618,191.00.

of, among other things, a detailed breakdown of TMP Acquisitions' QEZE TRC calculation for Mr. Laughlin. The record includes a detailed breakdown of TMP Acquisitions' QEZE TRC calculation for Mr. Laughlin.

23. On or about December 21, 2017, Mr. and Mrs. Laughlin jointly filed a form-IT-201-X, amended resident income tax return for the year 2016 (Laughlin 2016 amended income tax return). The reason given for amending the return was "Credit claim." On their amended income tax return, Mr. and Mrs. Laughlin claimed, among other credits, a QEZE TRC in the amount of \$113,320.00, and a QEZE RPTC in the amount of \$11,837.00. Among the numerous forms attached to the Laughlin 2016 amended income tax return were form IT-604 and form IT-606. On the form IT-604, Mr. and Mrs. Laughlin reported the qualified QEZE business as TMP Acquisitions, and in Schedule F – QEZE tax reduction credit, reported a tax year 14 of the business benefit period, a benefit period factor of 0.2, an employment increase factor of 1.0000, a zone allocation factor of 1.0000, a tax factor of \$566,602.00,⁵ and a QEZE tax reduction credit available for use of \$113,320.00. On form IT-604, Schedule G – Beneficiary's and fiduciary's share of QEZE income, Mr. and Mrs. Laughlin reported a total share of QEZE income in the amount of \$6,477,446.00, consisting of TMP Acquisitions' share of QEZE income of \$6,477,446.00. On the form IT-606, Mr. and Mrs. Laughlin reported a total QEZE credit for real property taxes in the amount of \$11,837.00, consisting of TMP Acquisitions' share of QEZE RPTC of \$11,837.00. After applying all claimed credits, including the QEZE TRC and the QEZE RPTC, New York State tax withheld in the amount of \$103,137.00, total estimated

⁵ To compute the tax factor, Mr. and Mrs. Laughlin first divided the income from the QEZE allocated within New York State of \$6,477,446.00 by their New York adjusted gross income of \$7,292,922.00, the result of which was 0.8882. Then, they multiplied 0.8882 by their tax of \$637,922.00 and determined their tax factor to be \$566,602.00.

payments in the amount of \$132,242.00, against the tax determined to be due, and then adding back the overpayment shown on the original return in the amount of \$5,265.00, Mr. and Mrs. Laughlin reported an amended tax due in the amount of \$145,792.00.

24. On or about April 6, 2018, the Division completed its review of the Laughlin 2016 income tax return and the Laughlin 2016 amended income tax return. Based upon its audit review, the Division allowed the investment tax credit in the amount of \$136,059.00 as claimed, but disallowed the claimed QEZE credits, i.e., the QEZE RPTC and the QEZE TRC, in full. The Division determined that the QEZE credits should be denied because TMP Acquisitions “is the parent company of a QSSS which has two certified QEZE’s as members.” Since TRS “has an eligibility date in 2004” and TMP Technologies “has an eligibility date in 2000,” the Division concluded that the earlier eligibility date should be used for the benefit period. Therefore, no QEZE benefits remained. The Division’s audit conclusions resulted in additional tax due in the amount of \$242,134.00. In its calculation of additional tax due, the Division allowed a nonrefundable college tuition credit in the amount of \$800.00, a nonrefundable investment tax credit in the amount of \$136,059.00, and applied estimated payments in the amount of \$10,000.000, withholdings in the amount of \$103,137.00 and a payment with the amended return in the amount of \$145,792.00.

25. On April 12, 2018, the Division issued to Mr. and Mrs. Laughlin a notice of deficiency, assessment ID L-047907374, asserting additional tax due in the amount of \$387,926.00,⁶ plus interest, on the 2016 amended income tax return that they filed on December

⁶ The additional tax amount asserted as due on this notice of deficiency does not reflect the \$145,792.00 payment that Mr. and Mrs. Laughlin made with the amended return.

28, 2017. The “Explanation” section of the notice of deficiency provided, in relevant part, as follows:

“This assessment is the result of the denial in full of your QEZE Tax Reduction Credit and QEZE Real Property Tax Credit. You also had a \$122,242 discrepancy in the amount of estimated payments claimed on line 75 of your IT-201. The result is tax due in the amount of \$387,926.

Reference Tax Law Section 208 1-B. ‘The term ‘QSSS’ means a corporation which is a qualified subchapter S subsidiary as defined in subparagraph (B) of paragraph three of subsection (b) of section thirteen hundred sixty-one of the internal revenue code. The term ‘exempt QSSS’ means a QSSS exempt from tax under this article as provided in paragraph (k) of subdivision nine of this section, or a QSSS described in subclause (i) of clause (B) of subparagraph two of paragraph (k) of subdivision nine of this section, wherein the parent corporation of the QSSS is subject to tax under this article, and the assets, liabilities, income and deductions of the QSSS are treated as the assets, liabilities, income and deductions of the parent corporation.

Where a QSSS is an exempt QSSS, then for all purposes under this article: (a) the assets, liabilities, income, deductions, property, payroll, receipts, capital, credits, and all other tax attributes and elements of economic activity of the QSSS shall be deemed to be those of the parent corporation.’ Also reference TSB-M-97 (6) C.

When the QSSS election was made 5/1/2015 there were two QEZE.s which became part of the QSSS with TMP Acquisitions, Inc. as the parent company. The earliest of the two eligibility dates will determine the benefit period factor used by the parent when claiming QEZE benefits. TMP Technologies, Inc. has an eligibility date of 12/27/2000 as a result no eligibility for QEZE benefits remain in 2016.”

26. Subsequently, on April 17, 2018, the Division issued to Mr. and Mrs. Laughlin a notice of adjusted assessment, assessment ID L-047907374, that adjusted the assessment sent to them on April 12, 2018. The notice of adjusted assessment asserted additional tax due in the amount of \$242,134.00, plus interest, on the Laughlin amended income tax return filed on December 28, 2017.⁷

⁷ This notice of adjusted assessment reflects Mr. and Mrs. Laughlin’s payment in the amount of \$145,792.00 made with the amended income

Kirk C. and Nicole L. Dorn, DTA No. 828789

27. On or about April 12, 2016, petitioners, Kirk C. and Nicole L. Dorn, jointly filed a form IT-201 for the year 2015 (Dorn 2015 income tax return).⁸ On that return, Mr. and Mrs. Dorn reported an investment tax credit (ITC) of \$110,334.00, a QEZE TRC of \$54,317.00, and a QEZE RPTC of \$6,532.00. Mr. and Mrs. Dorn reported a New York State tax liability in the amount of \$110,334.00, applied nonrefundable credits of \$110,334.00, consisting of a QEZE TRC of \$54,317.00 and an ITC of \$56,017.00, and reported a net tax liability of zero. They also reported total payments and refundable credits in the amount of \$21,906.00, consisting of a QEZE RPTC of \$6,532.00 and withholdings in the amount of \$15,374.00. They also requested that the overpayment in the amount of \$21,906.00 be refunded to them.

28. The Division conducted an audit of the flow-through credits claimed on the Dorn 2015 income tax return. Based upon its audit review, the Division reduced Mr. and Mrs. Dorn's claimed refund from \$21,906.00 to \$15,374.00. On April 4, 2017, the Division issued to Mr. and Mrs. Dorn a notice of disallowance for "audit period: 2015." This notice of disallowance provided, in relevant part, as follows:

"After a review of your flow-through tax credits for the above referenced audit period adjustments have been made. The result is that your requested refund of \$21,906 is reduced to \$15,374.

QEZE Real Property Tax Credit/QEZE Tax Reduction Credit

Reference Tax Law Section 208 1-B. 'The term 'QSSS' means a corporation which is a qualified subchapter S subsidiary as defined in subparagraph (B) of paragraph three of subsection (b) of section thirteen hundred sixty-one of the internal revenue code. The term 'exempt QSSS' means a QSSS exempt from tax under this article as provided in paragraph (k) of subdivision nine of this section,

⁸ The record does not include a copy of the Dorn 2015 income tax return. However, the record does include copies of the form IT-201-X filed by Mr. and Mrs. Dorn for the year 2015 (Dorn 2015 amended income tax return). On or about March 26, 2018, the Dorn 2015 amended income tax return was filed "under protest due to unresolved QEZE credit issues. This protective claim is to preserve the statute of limitations to claim the refund due upon resolution."

or a QSSS described in subclause (i) of clause (B) of subparagraph two of paragraph (k) of subdivision nine of this section, wherein the parent corporation of the QSSS is subject to tax under this article, and the assets, liabilities, income and deductions of the QSSS are treated as the assets, liabilities, income and deductions of the parent corporation. Where a QSSS is an exempt QSSS, then for all purposes under this article: **(a) the assets, liabilities, income, deductions, property, payroll, receipts, capital, credits, and all other tax attributes and elements of economic activity of the QSSS shall be deemed to be those of the parent corporation.**' Also reference TSB-M-97 (6) C.

Based upon the above both QEZE credits from TMP Acquisitions, Inc. have been disallowed in full. When the QSSS election was made 5/1/2015 there were two QEZE's which became part of the QSSS group with TMP Acquisitions, Inc. as the parent company. The earliest of the two eligibility dates will determine the benefit period factor used by the parent when claiming QEZE benefits. TMP Technologies, Inc. has an eligibility date of 12/27/2000 making 2015 year 15 with no eligibility for QEZE benefits remaining.

Investments Tax Credit (ITC)

Due to the disallowed QEZE Tax Reduction Credit your non-refundable ITC was increased by \$54,317 to \$110,334 to fully offset the disallowed credit. Your carry-forward on non-refundable ITC to 2016 is reduced to \$483. Please update your records accordingly."

29. On April 21, 2017, the Division issued to Mr. and Mrs. Dorn an account adjustment notice – personal income tax (refund ID number: 0064370978) that adjusted the refund requested in the amount of \$21,906.00 and allowed a refund in the amount of \$15,805.17 for the year 2015. The reason for the adjustment was “[w]e adjusted your total NY State, NY City and Yonkers refundable credits based on the information reported on Form 201/3-ATT, *Other Tax Credits and Taxes.*”

30. On or about December 27, 2017, Mr. and Mrs. Dorn filed a form IT-201-X for tax year 2016 (Dorn's 2016 amended income tax return).⁹ The reason given for amending the return was

⁹ The form IT-201 that Mr. and Mrs. Dorn filed for the year 2016 is not part of the record.

“to change the benefit period on NYS form IT-604 from 13 years to 14 years and to claim a reduced QEZE real estate tax credit on form IT-606 due to the same benefit period change.”

On the Dorn’s 2016 amended income tax return, they claimed an ITC in the amount of \$68,513.00, a QEZE TRC in the amount of \$61,412.00, and a QEZE RPTC in the amount of \$5,919.00. Among the numerous forms attached to the Dorn’s 2016 amended income tax return were form IT-604 and form IT-606. On the form IT-604, in schedule F – QEZE tax reduction credit, Mr. and Mrs. Dorn reported a tax year 14 of the business benefit period, a benefit period factor of 0.2, an employment increase factor of 1.0000, a zone allocation factor of 1.0000, a tax factor of \$307,061.00,¹⁰ and a QEZE tax reduction credit available for use of \$61,412.00. On their form IT-606, Mr. and Mrs. Dorn reported a QEZE credit for real property taxes in the amount of \$5,919.00. After applying all claimed credits, including the QEZE TRC and the QEZE RPTC, New York State tax withheld in the amount of \$14,851.00, and total estimated payments in the amount of \$34,934.00, Mr. and Mrs. Dorn reported an amended tax due in the amount of \$121,647.00.

31. The Division conducted an audit review of the pass-through credits claimed on the Dorn 2016 amended income tax return. As a result of its audit review, the Division allowed an investment tax credit in the amount of \$68,513.00,¹¹ but disallowed the claimed QEZE credits, i.e., the QEZE RPTC and the QEZE TRC in full. The Division determined that the QEZE credits should be denied because TMP Acquisitions “is the parent company of a QSSS which has

¹⁰ To compute the tax factor, Mr. and Mrs. Laughlin first divided the income from the QEZE allocated within New York State of \$3,499,425.00 by their New York adjusted gross income of \$3,501,802.00, the result of which was 0.9923. Then, they multiplied 0.9923 by their tax of \$307,276.00 and determined their tax factor to be \$307,061.00.

¹¹ The audit notes indicate that “Carry-forward reduced in prior audit to \$483. Current year CT-46 ITC claim allowed as claimed.”

two certified QEZE's as members." Since TRS "has an eligibility date in 2004" and TMP Technologies "has an eligibility date in 2000," the Division concluded that the earlier eligibility date should be used for the benefit period. Therefore, no QEZE benefits remained. The Division's audit conclusions resulted in additional tax due in the amount of \$67,331.00. In its calculation of additional tax due, the Division allowed a nonrefundable investment tax credit in the amount of \$68,513.00, and applied estimated payments in the amount of \$34,934.000, withholdings in the amount of \$14,851.00 and a payment with the amended return in the amount of \$121,647.00.

32. On April 12, 2018, the Division issued to Mr. and Mrs. Dorn a notice of deficiency, assessment ID L-047907246, asserting additional tax due in the amount of \$67,331.00, plus interest, on the amended income tax return that they filed December 26, 2017. The "Explanation" section of the notice of deficiency provided, in relevant part, as follows:

"This assessment is the result of the denial in full of your QEZE Tax Reduction Credit and QEZE Real Property Tax Credit. The result is tax due in the amount of \$67,331.

Reference Tax Law Section 208 1-B. 'The term 'QSSS' means a corporation which is a qualified subchapter S subsidiary as defined in subparagraph (B) of paragraph three of subsection (b) of section thirteen hundred sixty-one of the internal revenue code. The term 'exempt QSSS' means a QSSS exempt from tax under this article as provided in paragraph (k) of subdivision nine of this section, or a QSSS described in subclause (i) of clause (B) of subparagraph two of paragraph (k) of subdivision nine of this section, wherein the parent corporation of the QSSS is subject to tax under this article, and the assets, liabilities, income and deductions of the QSSS are treated as the assets, liabilities, income and deductions of the parent corporation.

Where a QSSS is an exempt QSSS, then for all purposes under this article: (a) the assets, liabilities, income, deductions, property, payroll, receipts, capital, credits, and all other tax attributes and elements of economic activity of the QSSS shall be deemed to be those of the parent corporation.' Also reference TSB-M-97 (6) C.

When the QSSS election was made 5/1/2015 there were two QEZE.s which became part of the QSSS with TMP Acquisitions, Inc. as the parent company.

The earliest of the two eligibility dates will determine the benefit period factor used by the parent when claiming QEZE benefits. TMP Technologies, Inc. has an eligibility date of 12/27/2000 as a result no eligibility for QEZE benefits remain in 2016.”

33. Neither Mr. and Mrs. Laughlin, nor Mr. and Mrs. Dorn claimed any New York State resident credits on their respective 2015 and 2016 resident income tax returns.

34. In their petition, Mr. and Mrs. Laughlin challenge the Division’s reduction or disallowance of the QEZE credits claimed on their income tax returns filed for the years 2015 and 2016, which reduction or disallowance resulted in assessments of additional tax due for both years.

35. In their petition, Mr. and Mrs. Dorn challenge the Division’s disallowance of the pass-through QEZE credits claimed on their income tax returns filed for the years 2015 and 2016, which disallowances resulted in an adjustment to their claimed refund for the year 2015 and the assessment of additional tax due for the year 2016.

CONCLUSIONS OF LAW

A. In 1986, the legislature enacted New York State’s Economic Development Zones (the EDZ Program). The purpose of the program was to stimulate private investment, private business development, and job creation in targeted geographic areas characterized by persistent poverty, high unemployment, shrinking tax bases and dependence upon public assistance (*see* General Municipal Law § 956). The EDZ Program offered a variety of state tax incentives designed to attract new businesses to the state and to enable existing businesses to expand and create more jobs (*see id.*). Over time, the EDZ Program gradually shifted its focus from poverty reduction to business development by relaxing eligibility requirements, and the program was changed to the Empire Zones Program Act in May of 2000 (L. 2000, ch. 63, part GG).

B. Businesses located in qualifying Empire Zone areas and that otherwise meet the statute's criteria could apply to the Department of Economic Development for a certificate of eligibility that they could then submit to the Department of Taxation and Finance in support of their claim for tax credits. These businesses are also referred to as QEZEs (*see* General Municipal Law § 959 [a]). A QEZE is a business enterprise which is certified under article 18-B of the General Municipal Law and meets the employment test (Tax Law § 14 [a]). As stated above, TRS and TMP Technologies are QEZEs. Among the credits available to QEZEs were the RPTC and the TRC. Mr. Laughlin was a 15% shareholder of both TRS and TMP Technologies.

C. TRS, an S corporation, was certified under article 18-A on October 20, 2004. TMP Technologies, an S corporation, was certified under article 18-A on December 27, 2000. On April 30, 2015, TMP Acquisitions, an S corporation, purchased 100% of the stock of both TRS and TMP Technologies. TRS and TMP Technologies elected to treat the purchase transaction between the shareholders of the corporations and TMP Acquisitions under 26 USC (IRC) §338 (h) (10). Effective May 1, 2015, both TRS and TMP Technologies are QSSSs, with TMP Acquisitions as the parent S corporation. TMP Acquisitions' two shareholders are Mr. Laughlin, who owns 66.6667%, and Mr. Dorn, who owns 33.3333%. For its tax years ended October 31, 2015, and October 31, 2016, TMP Acquisitions allocated to each shareholder his proportionate share of the QEZE credits to be claimed on his 2015 and 2016 New York State personal income tax returns.

D. On their respective income tax returns filed for the years 2015 and 2016, Mr. Laughlin and Mr. Dorn each claimed pass-through QEZE credits, i.e., the QEZE RPTC and the QEZE TRC, from TMP Acquisitions. The Division disallowed TMP Acquisitions' QEZE credits because when the QSSS election was made on May 1, 2015, TRS and TMP Technologies

became part of one QSSS with TMP Acquisitions as the parent company, with the earliest of the two QEZE's eligibility dates used to determine the benefit period factor used by the parent when claiming QEZE benefits. Based upon TMP Technologies' certification date of December 27, 2000, the Division concluded that 2015 was tax year 15 for purposes of the tax benefit period and, therefore, TMP Acquisitions was no longer entitled to empire zone benefits in either 2015 or 2016. In its brief, the Division asserts that, as a result of the QSSS elections by TRS and TMP Technologies, both companies are treated as one and the same entity for Empire Zones purposes, and the earliest date of certification under the Empire Zones program becomes the controlling date for both business enterprises acquired by TMP Acquisitions. Petitioners contend that the Division provided no support for its assertion that the certification date for TRS was changed by the transaction. They further contend that the Division ignored the statutory language of article 18-B and Tax Law § 14 that make clear that Department of Economic Development certified each business enterprise under the Empire Zone program in accordance with separately submitted applications. Petitioners claim that there is no methodology for imputing the certification date of one QEZE to another regardless of later ownership changes.

E. The Division erroneously determined the benefit period for the QEZE credits claimed by TMP Acquisitions, as parent of TRS, a QSSS and a QEZE. Tax Law §§ 14, 15, and 16 provide tax credits to QEZEs. A QEZE is a business enterprise that has been certified under article 18-B that also meets an employment test (*see* Tax Law § 14 [a]). Tax Law §§ 15 and 16 provide for the QEZE real property tax credit and the QEZE tax reduction credit. The business tax benefit period for credits available under Tax Law §§ 15 and 16 is defined in relation to the certification date of the business enterprise (*id.*) Such benefit period is triggered by the business enterprise's first date of certification under article 18-B (*see* Tax Law § 14 [a] [1], [e]). As of

May 1, 2015, both TRS and TMP Technologies are disregarded for tax purposes, and all income, losses, and tax credits are reported on the corporate tax filings of TMP Acquisitions. However, both TRS and TMP Technologies continue to operate as separate business enterprises, with separate locations of operations, payroll, and payroll filings. A QSSS that is disregarded for tax purposes flows through to the parent company. Although the credit claim forms are submitted with the form CT-3-S of the parent, and the credits ultimately flow to the shareholders, the basis for each credit calculation results from the economic activity of the Empire Zones certified business enterprise. I conclude that the certification date for TRS to be used in connection with TMP Acquisitions' claims for the QEZE RPTC and the QEZE TRS was October 20, 2004. The Division's audit determination that the benefit period for such credits was expired was therefore improper.

F. It is noted that TMP Acquisitions' claim for the QEZE RPTC for the year 2015 included only eligible real property taxes paid by TRS during such year (*see* finding of fact 11). However, TMP Acquisitions' claim for the QEZE RPTC for the year 2016 erroneously included real property taxes paid by both TRS and TMP Technologies as eligible real property taxes (*see* finding of fact 12, footnote 2). The Division is directed to recompute the QEZE RPTC claimed by TMP Acquisitions for the years 2015 and 2016 in accordance with conclusion of law E, and then pass through the appropriate amounts of the recomputed QEZE RPTCs to Mr. Laughlin and Mr. Dorn to be claimed on their respective income tax returns for such years.

G. The TRC is computed pursuant to Tax Law § 16. Tax Law § 16 (b) provides that the amount of the TRC "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." Tax Law § 16 (f) (2) (C)

provides the following with respect to the determination of the tax factor for a shareholder in an S corporation:

“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.”

H. Tax Law § 16 (f) (1) states in relevant part that:

“The tax factor shall be, in the case of article twenty-two of this chapter, the tax determined for the taxable year under such subsections (a) through (d) of section six hundred one of such article.”

I. As a shareholder of both TRS and TMP Acquisitions, Mr. Laughlin claimed QEZE TRCs for the years 2015 and 2016. As a shareholder of TMP Acquisitions, Mr. Dorn claimed QEZE TRCs for the years 2015 and 2016. With respect to the year 2015, Mr. and Mrs. Laughlin claimed, among other credits, a QEZE TRC in the amount of \$220,201.00. On form IT-604, Mr. and Mrs. Laughlin reported, among other things, the qualified QEZE business as TRS, a benefit period factor of 0.8, an employment increase factor of 1.0000, a zone allocation factor of 1.0000, a tax factor of \$336,902.00 (*see* finding of fact 16, footnote 3), and a QEZE TRC available for use of \$220,201.00. On form IT-604, Mr. and Mrs. Laughlin reported a total share of QEZE income in the amount of \$3,833,390.00, consisting of TRS’ QEZE income of \$1,027,530.00 and TMP Acquisitions’ QEZE income of \$2,805,860.00. After its audit review of the claimed QEZE TRC, the Division disallowed it in full. In recomputing the QEZE TRC, the Division applied TRS’ BAP of 0.0117% (*see* finding of fact 9) to Mr. Laughlin’s reported TRS’ QEZE income of

\$1,027,530.00, reducing the amount of QEZE income allocated within New York State to \$120.00. The Division did not allow any QEZE income from TMP Acquisitions in the calculation of the tax factor based upon its determination that no eligibility for QEZE benefits remained (*see* finding of fact 19). The Division disallowed TMP Acquisitions' QEZE TRC claimed by Mr. Laughlin for the year 2016. It also disallowed TMP Acquisitions' QEZE TRC claimed by Mr. Dorn for the years 2015 and 2016. It is noted that the Division disallowed TMP Acquisitions' QEZE TRC for the years 2015 and 2016 based upon the base period factor, not the use of the BAP in the calculation of the tax factor. However, the Division maintains that in all instances, the BAP should be used in the calculation of the tax factor component of the TRC.

J. Petitioners contend that the Division's use of the BAP in the calculation of the TRC as a means of allocating income within New York State does not result in "providing an apportionment which reasonably reflects a portion of the shareholder's tax attributable to the income of the qualified empire zone enterprise" (Tax Law § 16 [f] [2] [C]). They claim that "the only permissible formula for the calculation of the tax factor is as follows: ((Shareholder's income from the S corporation allocated within the State) / (Shareholder's New York adjusted gross income)) x (Shareholder's Article 22 tax) [Tax Law § 16 (f) (2) (C)]." Petitioners further claim that "the only explicit qualification or condition on the outcome is that 'in no event may the ratio so determined exceed 1.0'" (*id.*). Petitioners maintain that in calculating the tax factor, they applied this formula to their tax positions as required by Tax Law § 16 (f) (2) (C) and accurately reported it.

K. Petitioners' position is in direct contradiction to the Appellate Division, Third Department's holding in *Matter of Purcell v New York State Tax Appeals Trib.*, 167 AD3d 1101 (3d Dept 2018), *appeal dismissed* 33 NY3d 999 (2019), *lv denied* 33 NY3d 913 (2019). In

Purcell, the S corporation at issue was certified as a QEZE and was a New York corporation that constructed commercial buildings mostly in New York and Virginia using prefabricated systems that it manufactured within an empire zone (*id.*). As an S corporation, its income and any applicable QEZE TRCs passed through to its sole shareholder, a New York resident, and such income was reported on his personal income tax returns that he jointly filed with his wife (*id.*). The taxpayers then calculated the TRC using all of the S corporation's income, including income derived from its operations in Virginia (*id.*). Upon review of petitioners' personal income tax returns for the relevant years, the Division determined petitioners had miscalculated the TRCs because they did not exclude their out-of-state income when calculating the tax factor despite the fact that it was not "allocated within the state" pursuant to Tax Law § 16 (f) (2) (C) (*id.*). The Division then applied the BAP to determine the portion of the S corporation's income that was allocated within the state for each of the relevant tax years (*id.*).

The Court determined that interpreting the meaning of the phrase "allocated within the state" was a question of statutory interpretation requiring consideration of the language and legislative history without deference to the Tax Appeals Tribunal's interpretation (*id.*; *Matter of Piccolo v New York State Tax Appeals Trib.*, 109 AD3d 107, 110 [3d Dept 2013]). The Court acknowledged that a tax credit is a form of exemption from taxation and must be strictly construed against the taxpayer, with any ambiguity to be held against the exemption (*id.*). It then noted that a taxpayer seeking an exemption from taxation bears the burden of proving a clear entitlement thereto showing that its suggested interpretation is the only reasonable construction (*id.*; *Piccolo*, 109 AD3d at 111-112). In rejecting the taxpayer's position, the Court found that the Division's method of applying the BAP to the S corporation's income gave meaning to the phrase "allocated within the state," and concluded that eligibility for the TRC for shareholders of

New York S corporations is based only upon income that is earned by such corporations within New York. The Court concluded as follows:

“Allocation of a New York S corporation’s income within the state to a nonresident shareholder’s New York adjusted gross income is determined by application of the BAP reported by the corporation. When calculating QEZE credits, it is rational to interpret Tax Law § 16 (f) to require similar allocation of New York S corporation’s income for resident shareholders based upon the BAP reported by the corporation.”

The Court noted that this interpretation ensures similar treatment of resident and nonresident shareholders of S corporations and ensures that QEZE tax credits are based upon economic activity that occurs within qualified empire zones.

L. Petitioners claim that unlike *Purcell*, all assets and employees of TRS are situated within New York and all of the income during the tax years at issue was earned from activity in New York State. Both Mr. and Mrs. Laughlin and Mr. and Mrs. Dorn maintain that they are not required to file tax returns in any state other than New York. Petitioners assert that simply selling products that may be shipped to out-of-state purchasers does not circumvent the legislative intent of the Empire Zones Program and is completely different than the taxpayers’ circumstances in *Purcell*. They contend that use of the BAP to reduce the TRC should only be applied when a taxpayer is seeking both a TRC and a resident credit on the same income. However, the holding in *Purcell* was not limited to the facts in that case. There, the Court squarely addressed the issue of whether the phrase “allocated within the state” excluded out-of-state income when calculating a shareholder’s QEZE tax reduction (167 AD3d at 1102-1103). The Court found that it does (*id.*). The Court did not qualify this holding as to what out-of-state income would trigger the use of the BAP (*see id.*). Moreover, to hold otherwise would render such language superfluous (*see id.*). Further, the resident credit involves a credit for residents against income tax otherwise due for any tax imposed by another state upon income derived

therefrom that is also taxable in New York and is not related to the tax credits awarded by the Empire Zones Program, including the TRC (*see* Tax Law § 620 [a]).

M. Petitioners also argue that application of the BAP in computing the tax factor of the TRC is contrary to the legislative purpose of the empire zones program. However, as the Court noted in *Purcell*, use of the BAP ensures that “QEZE tax credits are based on economic activity that occurs only within qualified empire zones” (167 AD3d at 1105).

N. With respect to its disallowance of the TRC claimed on Mr. and Mrs. Laughlin’s 2015 income tax return, the Division’s use of the BAP in determining the tax factor of the TRC was proper.

O. In sum, the Division is directed to recompute TMP Acquisitions’ RPTC for the years 2015 and 2016, and then pass through the appropriate amounts of the recomputed RPTCs to Mr. Laughlin and Mr. Dorn to be claimed on their respective income tax returns for such years (*see* conclusions of law E and F). The Division is directed to use TRS’ benefit period for TMP Acquisitions’ TRC for the years 2015 and 2016 (*see* conclusion of law E).

P. The petition of Robert J. and Tammy L. Laughlin is granted in accordance with conclusions of law E, F, and O, and in all other respects is denied; and the notices of deficiency dated April 13, 2017 and April 12, 2018, and the notice of adjusted assessment dated April 17, 2018, as modified in accordance with conclusions of law E, F, and O, are sustained.

The petition of Kirk C. and Nicole L. Dorn is granted in accordance with conclusions of law E, F, and O, and in all other respects is denied; and the account adjustment notice dated

April 21, 2017, and the notice of deficiency dated April 12, 2018, as modified in accordance with conclusions of law E, F, and O, are sustained.

DATED: Albany, New York
February 10, 2022

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE