STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **GRAPHITE METALLIZING HOLDINGS, INC.** for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Year 2005.	DECISION DTA NO. 822416

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on April 29, 2010. The Division of Taxation appeared by Mark Volk, Esq. (Clifford M. Peterson, Esq., of counsel). Petitioner appeared by O'Connor, Davies, Munns & Dobbins, LLP (Stuart S. Stengel, Esq., CPA, of counsel and Dean M. Hottle II, CPA).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument, at the request of the Division of Taxation, was heard on January 19, 2011 in New York, New York.

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

ISSUE

Whether the Division of Taxation properly denied petitioner's claim for a refund of the qualified empire zone enterprise credit for real property taxes based on its determination that petitioner did not have a valid business purpose for its reorganization and that the reorganization was undertaken solely to gain empire zone tax benefits.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "4" and "29," which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, Graphite Metallizing Holdings, Inc. (GMHI), originally incorporated in the State of Delaware on December 4, 1915 under the name Graphite Metallizing Corporation (GMC 1), became authorized to do business in New York later in the same year. GMC 1 manufactured graphite alloy bushings, brushes, bearings and slip rings, which are used as machine components.

On June 28, 1988, the real property of GMC 1 was designated into the Yonkers Empire Zone.

On May 18, 1995, the City of Yonkers Enterprise Zone certified GMC 1 as an empire zone enterprise under Article 18-b of the General Municipal Law.

We modify finding of fact "4" of the Administrative Law Judge's determination to read as follows:

> Mr. Hottle, an employee of BDO Seidman (an outside accounting firm retained by GMC 1) until June 2000, testified that GMC makes graphite bearings that are inserted into molten metal parts, which he described as a "dirty, dusty business" with the potential for someone to sustain a significant injury. He testified that he recommended reorganization because of the potential for injury, and also because of the environmental concerns. The reorganization involved adopting a holding company, with the operating companies reporting to the holding company. He further asserted that the advantage of the restructuring was that multiple companies, each separate from the others, could be acquired under the holding company, and significant financial problems of one company would not affect the others.
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> On the other hand, Mr. Hottle stated that with a "vertical structure," the problems of the parent holding company would affect all of the other companies

> underneath. BDO Seidman also discussed with GMC 1 the option of forming a limited liability corporation, or LLC. On March 2, 1998, BDO Seidman sent a memo to GMC 1, which outlined the advantages and disadvantages of an LLC. Several meetings were held to discuss the different structures.
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> A memo dated February 17, 1998 (Exhibit 10), which was sent to Mr. Murphy, an officer of GMC 1, from Richard Strickhof of BDO Seidman, contains only recommendations of methods for acquiring a new company: either the purchase of assets or the purchase of its stock. It did not particularly recommend the form that the purchase might take, but contained diagrams of various methods of acquisition, merger or consolidation.
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> The QEZE program and the tax credits resulting therefrom were never discussed at the time that BDO Seidman recommended the holding company structure. It appears that this consideration was raised because of potential liabilities to the top tier company (i.e. the Yonkers company) from its use of the Croton Point Landfill, as well as the company's desire to continue expanding by purchasing other businesses.[1]

The minutes of meetings of the directors of GMC 1 from March 11, 1998 and May 20, 1998, reveal that there were discussions of various aspects pertaining to a proposed acquisition, and at the meeting of May 20, 1998, Mr. Eben T. Walker, president of GMC 1, asked for an opinion on setting up a "completely separate entity." At a stockholders meeting held on May 20, 1998, the minutes contained a President's Report that stated, in part, as follows:

> The coming year will be an even more exciting one with the possibility of tripling our sales volume through the acquisition of a company in a similar business. This acquisition, which is in the due diligence phase, will broaden our product coverage and eventually will increase the stability of our business. In the short term, this acquisition will increase the risk to our shareholders, but we believe that in the long term these risks are worthwhile.

At a special stockholders meeting of GMC 1 held on June 16, 1998, a restructuring of GMC 1 was discussed and a resolution was approved authorizing the directors to form subsidiaries, a holding company or a separate company "to best complete any approved

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[1] We modify this fact to more accurately reflect the record.

acquisition." The minutes of this meeting contain no mention of QEZE tax credits.

The minutes of a meeting of the directors of GMC 1 held on December 14, 1998, under the category "Environmental," contains a table showing progress made in recycling the company's waste. In addition, under the category "Legal," was a discussion of legal issues arising from GMC 1's use of the Croton Point Landfill.

The minutes from meetings of the directors of GMC 1 held on March 16, 1999, December 15, 1999 and May 23, 2000 contain references to discussions of GMC 1's potential liability at the Croton Point Landfill and discussions of the direction of GMC 1's future acquisitions.

GMC 1 did not make any changes to its corporate structure immediately. In January 1999, GMC 1 purchased a company known as Graphel, which is located in Cincinnati, Ohio.

By a letter to Louis A. Fenderk, Senior Vice President of KeyBank National Association, dated July 17, 2000, Joseph T. Murphy, Vice President and Treasurer of GMC 1, sought a loan for the "buy out of a leading manufacturer of specialty graphite." Mr. Murphy described the potential acquisition by stating that it would "expand our presence in the graphite industry and help protect our current position with the target [of the acquisition] as a key customer of GMC [1] and a key vendor for Graphel." Shortly thereafter, the company that GMC 1 was considering acquiring, Poco, was purchased by another company (GMC 1 was outbid by $2 million). In July 2002, GMC 1 did reorganize, following the consolidation pattern layed out in the BDO Seidman memo of February 17, 1998. By the time of the reorganization, Mr. Hottle was no longer in the employ of BDO Seidman.

On July 31, 2002, a subsidiary of GMC 1, known as Graphite Metallizing (New York),

Inc., was incorporated in the State of New York. On December 3, 2002, Graphite Metallizing (New York), Inc., was certified under Article 18-b of the General Municipal Law as an empire zone enterprise retroactive to July 31, 2002. After July 31, 2002, GMC 1 began operating as a holding company while Graphite Metallizing (New York), Inc., conducted the manufacturing business. Graphite Metallizing (New York), Inc., continued GMC 1's former business activities using the same assets and location with essentially the same workforce.

On December 20, 2002, GMC 1 conveyed its real property to its subsidiary, Graphite Metallizing (New York), Inc.

On April 18, 2003, GMC 1 which, as noted in the Findings of Fact above, was known by the corporate name of Graphite Metallizing Corporation since 1915, changed its name to Graphite Metallizing Holding Corporation and the name of Graphite Metallizing (New York), Inc., was changed to Graphite Metallizing Corporation (GMC 2).

On June 1, 2003, Graphite Metallizing Holding Corporation transferred to GMC 2 its cash, accounts receivable, prepaid expenses, inventory, machinery and equipment, investments in securities and other receivables and liabilities in exchange for the stock of GMC 2 pursuant to Internal Revenue Code (IRC) § 351.

On June 13, 2003, Graphite Metallizing Holding Corporation changed its name to Graphite Metallizing Holdings, Inc. (GMHI).

Beginning with the year 2003, GMHI and GMC 2 reported their tax liability in New York by filing combined returns.

For the year 2005, GMHI and GMC 2 filed a form CT-3-A, General Business

Corporation Combined Franchise Tax Return.[2] Along with the CT-3-A, GMHI also filed a form CT-606, Claim for QEZE [Qualified Empire Zone Enterprise] Credit for Real Property Taxes, on which a credit in the amount of $106,606.00 was claimed.

On line 100a of the form CT-3-A, entitled "Refund of unused tax credits," GMHI claimed a refund of $140,169.00, which amount included the $106,606.00 in unused QEZE credit for real property taxes (RPTC). GMHI also claimed an EZ investment tax credit and an EZ wage tax credit, neither of which is at issue in this proceeding.

In early 2007, the Division began a review of petitioner's refund claims for the tax credits claimed on the return filed for the 2005 tax year. GMHI (formerly Graphite Metallizing Corporation) became certified in the Yonkers Empire Zone in 1994. Pursuant to Tax Law § 14(e), (d) and (c)(1), respectively, GMHI's test date for QEZE credits is July 1, 2000, its test year is the taxable year ended December 31, 1999, and its base period consists of the calendar years 1994 through 1998.

QEZE real property tax credits were allowed to GMHI for the years 2003 and 2004 based upon GMC 2's qualifications. However, changes to the Tax Law effective for years beginning on or after January 1, 2005 required the Division to reexamine GMC 2's qualifications to claim the RPTC for the 2005 tax year.

One of the consequences of the 2005 amendments to the Empire Zones Program made by chapters 63 and 161 of the Laws of 2005 was that a business enterprise that was first certified in an Empire Zone prior to August 1, 2002 and had a base period of zero years or zero employment

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[2] GMHI, formerly Graphic Metallizing Corporation, had filed general business corporation franchise tax returns on a separate basis through the 2002 calendar year.

in the base period was subject to an amended employment test. GMC 2 was certified eligible to receive Empire Zone benefits effective July 31, 2002,[3] had zero employees in its base period and its average employment number for its test year (2001) was zero.

In addition, since GMC 2 was making the same products, using the same facilities at the same location under the same management and with the same employees as had GMHI, the Division determined that GMC 2 was substantially similar in operation and ownership to a business entity taxable or previously taxable under Article 9-A of the Tax Law. Accordingly, GMC 2 could not be deemed a new business if it was not formed for a valid business purpose, as defined in Tax Law § 208(9)(o)(1)(D), but solely to gain empire zone benefits.

During the audit, the Division determined that during the first half of 2003, GMHI discharged five employees and transferred the balance of its employees to GMC 2.

Absent its proving that it was formed for a valid business purpose and not solely to gain empire zone benefits, GMC 2, in order to qualify for the real property tax credit for the 2005 tax year, would have had to significantly increase its employment within the Empire Zone. If it had claimed the real property tax credit for the 2005 tax year, GMC 2's average number of employees for what would have been its test year, 1999, would have been 56.75 while its average employment number for the 2005 tax year would have been 44.75.

As noted above, the Division, having determined that GMC 2 was subject to the amended employment test, examined whether it was formed for a valid business purpose under the Tax Law.

The Division examined the form CT-3-A for the 2005 tax year. Attached to the tax form

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[3] GMC was certified in the Yonkers Empire Zone on December 3, 2002, retroactively to July 31, 2002.

was a notarized statement from Joseph T. Murphy, Vice President and Treasurer of GMHI. Mr. Murphy stated that GMHI and affiliates entered into a QEZE "for the valid business purpose of achieving cost certainty and facilitating growth in the economic downturn after the September 11, 2001 terrorist attacks." He further stated that because there was no economic recovery in sight in early 2002, there were two options for the continuance of GMHI's business in New York: (1) to relocate to Ohio where GMHI's subsidiary operated in a significantly lower cost jurisdiction; or (2) to restructure the New York operation "to contain costs and assist in the managing, financing and assimilating of new business." Mr. Murphy indicated that choosing the second option "allowed us to remain in Yonkers and also provided the advantage of utilizing QEZE benefits."

Mr. Murphy's statement included no mention of the following reasons for creating a subsidiary: (1) environmental concerns; (2) protection of GMHI from liability issues arising from the Croton Point Landfill; (3) isolation of the Yonkers and Ohio businesses from each other's debt or financial losses; (4) providing a structure to allow for the divestment of one of the companies; and (5) delineating banking relationships among companies.

By letter dated January 22, 2007, the auditor requested certain documentation from GMHI, which included, among other things:

a. Referring to Joseph T. Murphy's notarized statement attached to the form CT-3-A, an explanation as to how the reorganization with a newly formed GMC 2 "served to contain costs and assist in the managing, financing, and assimilating of new business."

b. An explanation as to "what part QEZE benefits [played] in restructuring the

New York operation.

c. An explanation as to how GMC 2's stated business purpose has changed the economic position of GMC 2 and GMHI in a meaningful way.

d. A copy of the board of directors minutes that "pertain to setting up GMC [2] as a QEZE" and "copies of the Board of Directors minutes for all meetings pertaining to the operation of GMC[2] as a QEZE enterprise since its inception."

e. Copies of "all internal memos, emails, and other documentation that pertain to the restructuring of the New York operation."

f. Copies of "all correspondence with consultants, representatives or outside third parties who advised [GMHI] about restructuring the New York operation. Include all correspondence that alleges inadequacies of the former business structure which gave rise to the need for a separate legal entity to hold the real property."

g. A copy of the Articles of Incorporation of GMC 2.

By a letter dated April 17, 2007, Mr. Murphy responded to the auditor's letter. Along with the letter, Mr. Murphy included a number of attachments. In response to the auditor's request, Mr. Murphy's letter set forth an explanation for the reorganization, which stated, in part, as follows:

> In early 2002, there was no normal economic recovery in sight. There seemed to be three obvious options. One would be to consolidate the two locations to reduce direct and indirect costs under existing ownership. Since Yonkers was not a viable option, Ohio, with more than twice as many employees, would be the natural first choice. The second option was to sell the Yonkers business to a company that could achieve economies of scale to offset the economic downturn, but this again would mean closure of the Yonkers plant and moving out of NYS. The third option would be to make changes in both operations to increase sales and lower costs. In any case, we needed a legal and reporting structure that would allow us to better focus on, evaluate and manage the two locations as independent

> businesses more effectively. It should also facilitate oversight of future acquisitions and divestitures.
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> * * *
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> Furthermore, our outside legal and audit/tax firms advised us that the establishment of a holding company structure would best meet our organizational and reporting needs and allow us to manage current and future separate businesses as a portfolio of investments.
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> At that time, we were advised that there was also the opportunity to not only achieve the organizational benefits of a holding company structure, but also reduce labor & overhead costs in Yonkers by establishing a QEZE company with related personnel & property tax benefits. Thus the QEZE benefits were a secondary benefit and not the primary reason for the reorganization.

In his letter dated April 17, 2007, Mr. Murphy did not identify environmental concerns as a business purpose for the creation of GMC 2. He did not identify the protection of GMHI from liabilities posed by the Croton landfill as a business purpose for the creation of GMC 2. He did not address the need to create GMC 2 to isolate the Yonkers and Ohio companies from each other's debts and financial losses and did not speak to GMHI's concern that without creating a subsidiary, banks could cross collateralize the assets of the Yonkers and Ohio businesses.

In response to the auditor's requests set forth in her letter of January 22, 2007, Mr. Murphy provided, amongst other documents, the following:

a. Copies of board of directors' minutes relating to setting up GMC 2 and to the subsequent operation of GMC 2. There were minutes from 20 meetings of the boards of GMHI and GMC 2 from September 18, 2001 until April 24, 2006; and

b. Copies of correspondence from BDO Seidman from July 30, 2002 through June 10, 2003. According to Mr. Murphy's April 17, 2007 letter, the BDO correspondence "supports the premise that our primary emphasis was on

developing an organizational structure for the future and a byproduct was the QEZE benefits which allowed us to stay in Yonkers."

Copies of minutes from board of directors and stockholders meetings of GMC 1 were not provided to the auditor; Mr. Walker stated that they were not provided because they were not specifically requested. Minutes of such meetings were, however, introduced into evidence at the hearing held in this matter.

By a letter dated July 30, 2002, GMHI[4] engaged BDO Seidman to provide tax consulting services. A letter confirming such engagement was written on the letterhead of BDO Seidman, was addressed to Mr. Joseph Murphy and was signed by Nicholas A. Nesi, Partner. The copy of the letter presented to the Division during the audit (and which is part of the audit file) is not signed by a representative of GMHI. At the hearing, however, GMHI introduced into evidence a copy of the letter, which was signed by Mr. Murphy on September 20, 2002. This letter stated, in part, as follows:

> GMC would like to capitalize on opportunities which exist as a result of the 2000 Empire Zones Program Act, and recent New York State 2002-2003 Budget legislation and which may generate significant state and local tax savings and refunds.
>
> * * *
>
> BDO will review GMC business operations and the potential Empire Zone Credits available. Additionally, BDO would assist GMC with the developments and implementation of a restructuring program necessary to take advantage of these potential credits.

By a second letter dated July 30, 2002, written by BDO Seidman to Mr. Murphy, BDO Seidman informed GMC 1 that the definition of the term "new business" would be effective August 1, 2002, but would not apply to taxpayers certified as a QEZE under Article

[4] At the time of this letter, the company was still known as GMC.

18-B of the General Municipal Law before August 1, 2002 or taxpayers that received a letter of commitment regarding empire zone benefits before that date.

BDO Seidman suggested that the company pursue the following planning and restructuring strategies to maximize the benefits available from the Empire Zone Credits:

- Form new entity(ies) to:
  - hold and manage real estate in the zone; and/or
  - operate segments of the current business in the zone, including receive a transfer of certain existing employees of GMC; and/or
  - make limited strategic *new* employee hires *i.e.*, not a transfer from the current enterprise or a 'related person' pursuant to IRC § 465(b)(3)(c).
- Attempt to obtain QEZE certification or letter of commitment for Empire Zone benefits for the new entity(is) prior to August 1, 2002 in order to avoid restrictions associated with the definition of a *new business* enacted with the recent budget.

On September 11, 2002, a board of directors meeting of GMC 2 was held. Among those attending were Mr. Eben T. Walker (who presided over the meeting) and Mr. Joseph T. Murphy. Mr. Murphy made a presentation to the board concerning the Empire Zone Program. It was identified that "[t]he Empire Zone benefits will encourage GMC to continue our operation here in Yonkers rather than seeking alternative sites and to locate new activities and employees within the city."

The directors discussed the pros and cons of taking advantage of the Empire Zone Program. Mr. Murphy indicated that BDO Seidman strongly recommended that GMC take advantage of the program. Mr. Walker investigated the program with other local business people and "confirmed this opportunity."

We modify finding of fact "29" of the Administrative Law Judge's determination to read as follows:

> At GMHI's September 11, 2002 board of directors' meeting, a resolution was adopted by the board of directors to ratify the following actions to obtain the benefits available to companies within the Empire Zone.
>
> a. retaining a law firm to form a new corporation to be called Graphite Metallizing (New York), Inc.; and
>
> b. retaining BDO Seidman to make the application with the City of Yonkers for inclusion in the Empire Zone.
>
> The board also approved, subject to the advice of legal counsel and the final recommendation of management:
>
> c. the transfer of such real estate assets as required to be included in the Empire Zone to a wholly-owned subsidiary of GMHI; and
>
> d. retention of BDO Seidman "to complete the review and implementation of the program presented to management on September 5, 2002, a copy of which has been provided to the Board and discussed today."[5]

On December 3, 2002, the subsidiary, Graphite Metallizing (New York), Inc., was certified eligible to receive Empire Zone benefits. The eligibility was made effective retroactive to July 31, 2002.

On December 6, 2002, BDO Seidman notified GMHI of its success in having obtained QEZE certification for the wholly-owned subsidiary, Graphite Metallizing (New York), Inc., and described steps to maximize the empire zone benefits.

At GMHI's board of directors meeting held on December 10, 2002, Joseph Murphy reported to the board that "Graphite" had received "Empire Zone approval." "Graphite" was to begin filing the required documentation including the approval of the transfer of real estate that

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[5] We modify this fact to more accurately reflect the record.

had been previously approved.

At GMHI's board of directors meeting held on March 4, 2003, Mr. Murphy advised the board that "[w]ork is proceeding with the State of Delaware to change the company name to Graphite Metallizing Holding, Inc., so that the name 'Graphite Metallizing Corporation' can be used for the QEZE company." Mr. Murphy made a motion to hold a special shareholders meeting on April 10, 2003 to authorize a change of name from Graphite Metallizing Corporation to Graphite Metallizing Holding, Inc.

BDO Seidman wrote a letter to Joseph Murphy dated April 10, 2003. The letter stated in part as follows:

> Graphite Metallizing Corporation ("GMC") is restructuring its real property holdings and business operations for numerous business reasons including: streamline its corporate structure to reduce compliance costs, manage more efficiently and effectively its real property holdings and business operations, and obtain maximum Qualified Empire Zone ("QEZ") tax benefits.

The letter from BDO Seidman noted that GMC 1, on July 31, 2002, formed a 100% wholly-owned subsidiary, Graphite Metallizing (New York), Inc., and upon its formation, issued 100 shares of authorized stock.

In the letter, BDO Seidman never identified environmental concerns or a concern for the protection of GMHI from liabilities arising from the Croton dump as business purposes for the restructuring. Attached to the letter were various documents including a document entitled "QEZE Tax Credit Restructuring Planning Strategy" which is dated "4/10/2003." In the "Strategy," BDO Seidman indicated that it would be necessary to "[d]evelop and document business purposes for restructuring." According to the "Strategy," the target completion date for the development and documentation of the business purposes for restructuring was "09/05/02," a

date that was approximately six months prior to the date of the "Strategy."

According to the minutes of the May 13, 2003 meeting of its board of directors, GMHI, on April 10, 2003, changed its name from Graphite Metallizing Corporation to Graphite Metallizing Holdings, Inc. Graphite Metallizing (New York), Inc.'s name was changed to Graphite Metallizing Corporation on April 24, 2003.

In the minutes of its board of directors meeting held on November 10, 2003, GMC 2 (formerly Graphite Metallizing [New York], Inc.) identified that it was established "to participate as a Qualified Empire Zone Enterprise (QEZE)."

According to information attached to its federal form 1120 for the period ended December 31, 2003, GMHI, on June 1, 2003, pursuant to Internal Revenue Code § 351, transferred its cash, accounts receivable, prepaid expenses, inventory, machinery and equipment, investments in securities, other receivables and its liabilities to GMC 2 in exchange for the stock of GMC 2.

According to the minutes of a meeting of the board of directors of GMHI held on May 20, 2004, GMC 2 received a positive tax benefit of $100,000.00 as the result of being a qualified member of the QEZE. In order to participate in the QEZE exemption, $50,000.00 to $70,000.00 was spent.

The board of directors of GMC 2, in the minutes of its meeting held on October 25, 2005, noted as follows:

> The Qualified Empire Zone Enterprise (QEZE) economic incentives provide a significant reason for Graphite to maintain the company's long term relationship with the City of Yonkers. If the State were to discontinue to [sic] program, management would have to consider relocating with Graphite's sister company in West Chester, Ohio.

By a letter to Mr. Murphy dated June 21, 2007, the auditor requested certain additional information including copies of any additional correspondence (including email) that specifically proposed or discussed the following:

> a. The expected economic benefits, risks and responsibilities flowing to GMC as a result of the reorganization.
>
> b. The means by which the 'restructure of the New York operation' was expected to "contain costs and assist in the managing, financing and assimilating of new business."

In response to the auditor's letter of June 21, 2007, Mr. Murphy prepared a letter dated July 13, 2007, which stated, in part, as follows:

> As you know, my letter of April 17, 2007 in response to your original request for information of January 22, 2007 included over 150 pages of outside consultant and internal Board of Director documents in support of GMC's [GMC 2's] compliance with the law in effect at the time and right to receive the QEZE benefits that are being withheld. Beyond the previously supplied tax materials, no other written documentation exists regarding our reorganization.

Mr. Murphy then proceeded to summarize how and why GMC 2 was established as a QEZE legal entity. Among the points included in the summary were:

> a. A legal and reporting structure was needed that would allow the company to better focus on, evaluate and more effectively manage the two locations (Yonkers and the subsidiary, Graphel, located in Ohio) as independent businesses.
>
> b. A reduction in labor and overhead costs in Yonkers by establishing a QEZE company with related personnel and property tax benefits.
>
> c. The new legal and operational structure would facilitate future acquisitions and divestitures.
>
> d. The action of establishing GMHI as a holding company and the other steps

taken in the reorganization were effective and yielded positive results among which were a 50% increase in sales from a low of $18.6 million in 2002 to over $28 million in 2006. In addition, new operations were added in Minnesota, Wisconsin and Connecticut.

On August 15, 2007, the auditor issued a formal notice to GMHI disallowing its claim for a RPTC in the amount of $106,606.00. The notice concluded as follows:

We conclude that GMC [GMC 2], operating the same business with the same employees and under the same beneficial ownership as GMHI, does not qualify as a "new business" under Article 1, section 14(j) of the Tax Law because it was not formed for a valid business purpose. Therefore, GMC [GMC 2] does not meet the QEZE employment test for the taxable year ended 12/31/05.

Among the reasons for the auditor's conclusion were the following:

a. No documenting evidence in the board of directors minutes of GMC 2 and GMHI leading up to GMC 2's incorporation and QEZE certification or in any other correspondence received that illustrates or discusses how the segregation of assets, employees and investments into three separate legal entities, rather than one legal entity, was expected to achieve cost certainty and facilitate growth, or to contain costs and assist in the managing, financing and assimilating of new business.

b. Not until BDO Seidman's letter dated April 10, 2003, issued eight months after GMC 2's organization and four months after GMC 2's empire zone certification, is there a mention made of "numerous business reasons" for the restructuring.

> Other than in the opening paragraph, the BDO Seidman document makes no mention of cost containment, management benefit, business assimilation or any other valid business purpose for the formation of GMC 2. It does, however, go on to discuss "exclusively" the steps required to "maximize the QEZE benefits."

At the hearing, the auditor stated that she and her supervisors found "the documents that were contemporaneous with the formation of the subsidiary [GMC 2]" to be the most relevant to a determination of whether there was a valid business purpose for the creation of GMC 2. The auditor indicated that these contemporaneous documents were the most relevant "[b]ecause they would indicate to us what was in the mind of the taxpayer at the time." The auditor stated that the contemporaneous documents were the minutes of GMHI's board of directors meeting of September 11, 2002 and the two BDO Seidman letters dated July 30, 2002.

In addition, the auditor found additional support for her conclusion in the minutes of GMC 2's board of directors meeting held on November 10, 2003 where, under the category "Old Business," it stated that the company "was established on July 31, 2002, to participate as a Qualified Empire Zone Enterprise (QEZE)."

Also, in a letter to Joseph Murphy from BDO Seidman on April 10, 2003, other than the mention of reducing compliance costs and managing real property holdings in the opening paragraph, there is no other mention of these two reasons in the rest of the letter, which "is completely about Empire Zone benefits." The audit report noted that the BDO Seidman letter was written eight months after GMC 2's organization and four months after its empire zone certification and was not, therefore, contemporaneous with the formation of GMC 2.

In its petition filed with the Division of Tax Appeals, GMHI asserted the following:

> Taxpayer has good and sufficient business purpose, other than tax benefits, for its corporate restructuring in 2002.
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> The period 2000 through 2003 were difficult economic times for most industrial companies. The Board of Directors of Graphite Metallizing Corporation was advised to reorganize their corporate structure for years by outside accounting and legal advisors. A reorganized Graphite would be able to borrow money at the subsidiary level without obligating the parent company. It would be able to buy or sell each company without affecting the other companies. Most important, it could file bankruptcy for one of the companies without filing the other companies.

After issue had been joined, the Division requested and received from GMHI's representative a copy of the BDO Seidman document entitled "Graphite Metallizing Corporation, Empire Zone Program Review," which was dated September 5, 2002. This report had not previously been provided to the Division during the audit. The report was mentioned in the minutes of GMHI's board of directors meeting held on September 11, 2002.

The report contains a presentation of anticipated Empire Zone tax credits that GMHI might be able to claim if it created a new subsidiary. In a chart entitled "Overview of Value Creation," BDO Seidman indicated:

Tax Reduction Credit	$666,804
Potential Refundable Wage Tax Credit	$187,500
RPTC Applied Against Tax	$66,340
RPTC Potential Refundable Tax Credit	$653,660
Potential Sales & Use Tax Exemption	$7,620
TOTAL VALUE	$1,581,924*
Enhanced Investment Tax Credit	To Be Determined

*Total value base on life of credits & incentives available.

In the report, BDO Seidman indicated that it had already applied on behalf of "Graphite"

for preliminary certification as a QEZE.

Eben T. Walker, president of "Graphite" for over 25 years, stated that the City of Yonkers (where GMC 1 had been located since 1915) was very interested in keeping the company in Yonkers, especially in light of the fact that it knew of the existence of Graphel in Ohio. The city held seminars for a number of the local businesses to discuss the various programs available to these businesses. The Empire Zone credits were one of the programs discussed.

Joseph. T. Murphy, Graphite's vice president, treasurer and chief financial officer, stated that GMC 1's net income in 2001 was over $700,000.00. Because of the events of September 11, 2001, GMC 1 lost $2,300,000.00. The Cincinnati operation, Graphel, went from $60,000,000.00 in sales in 2000 to $11,000,000.00 in sales in 2003.

Mr. Murphy indicated that in July 2002, BDO Seidman came to GMC 1 and said that since GMC 1 was going to reorganize anyway, why not do it now to get an opportunity at the empire zone credits. We decided "we are going to do it anyway, why not hit that target date?"

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge found that while it can be reasonably argued that at the exact time of the restructuring, i.e., the creation of Graphite Metallizing (New York), Inc., (later Graphite Metallizing Corporation, [GMC 2]), the primary motivation was to gain Empire Zone benefits, it was not the sole motivation. The timing of the restructuring clearly reflected the company's desire to avoid having to meet the restrictive definition of a new business as set forth in amendments to Tax Law § 14(j). However, the Administrative Law Judge determined that petitioner had satisfied its burden of proof by providing considerable evidence (documentary evidence and testimony) to show that GMC 2 was formed for valid business purposes (in

addition to obtaining QEZE tax credits), and those purposes were to facilitate the acquisition of other companies, to increase sales volume and market share in the graphite industry, and to isolate business risks and potential liability arising out of the use of the Croton Point Landfill. Thus the Administrative Law Judge found that the Division improperly denied petitioner's claim for a refund of the qualified empire zone enterprise credit for real property taxes for the year 2005.

ARGUMENTS ON EXCEPTION

The Division argues that the determination below should be reversed because the Administrative Law Judge erroneously concluded that petitioner met the requirements of Tax Law § 14(j)(4)(B) when it reorganized and created GMC 2. It advances several points in its favor. The Division argues that the Administrative Law Judge misinterpreted the valid business purpose, as construed in sham transaction jurisprudence, which led to an erroneous conclusion. The Division also argues for reversal because the Administrative Law Judge erred in considering evidence prior to July 31, 2002, and made erroneous evaluations of credibility and weight.

Petitioner asserts that the documents dated prior to formation, as well as the witness testimony, are necessary and relevant to determining a valid business purpose. Petitioner states that the Administrative Law Judge properly considered this evidence and correctly determined that legitimate business concerns drove the reorganization of GMC 1 and the formation of GMC 2. It also argues that the reorganization met the intent of the Empire Zone Program because it allowed their business to continue operating in Yonkers, New York. Accordingly, petitioner requests that the determination of the Administrative Law Judge be affirmed in its entirety and the refund granted.

OPINION

In addressing the issue presented, we deem it appropriate to review the legislative history associated with the QEZE real property tax credits. In doing so, we note that our primary objective is to "ascertain and give effect to the intention of the Legislature" (***Matter of Yellow Book of New York v. Commissioner of Taxation and Fin.***, 75 AD3d 931, 932 [2010], ***citing Riley v. County of Broome***, 95 NY2d 455 [2000]).

In 1986, the Legislature passed the Economic Development Zone Program,[6] established under Article 18-B of the General Municipal Law. This Act seeks to improve economic conditions in impoverished areas of New York by stimulating private investment, business development and job creation (General Municipal Law § 956).

Under Article 18-B, taxpayers can be certified as qualified empire zone enterprises (***see*** General Municipal Law § 958; Tax Law § 14[a]). A taxpayer must meet certain qualifications to be certified as a QEZE, including an employment and job creation test (***see*** Tax Law § 14[a]). This test compares the number of jobs had by a qualified business in its base period against its number of jobs in subsequent periods (Tax Law § 14[b][1]). QEZE status provides eligibility for certain tax preferences in the form of credits and exemptions. These benefits include a credit for real property taxes set against corporate franchise taxes under Article 9-A (Tax Law § 15[a]; 16[a]). These are the tax credits at issue.

After the year 2000, the Legislature identified abuses of the Economic Zones program in a process known as "shirt changing," whereby an existing business would reorganize into a new

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[6] As of May 2000, the term Economic Development Zone was replaced with Economic Zone by chapter 63 of the Laws of 2000, which also created Qualified Empire Zone Enterprises.

entity to qualify for, or enhance, its QEZE benefits. The Legislature held this practice to be inconsistent with the intent of the program (General Municipal Law § 956), and sought to reform the legislation.

The Legislature reformed the Empire Zone Program by modifying the employment tests used to acquire QEZE benefits. In chapter 161 of the Laws of 2005, the Legislature amended Tax Law § 14(b)(1) to provide that:

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

As relevant herein, Tax Law § 14(j)(4)(B), which was added in 2002, provided that a corporation or partnership:

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

Tax Law § 208(9)(o)(1)(D) provides the relevant definition of valid business purpose, which states:

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

We view the Legislature's intent to be incorporating the subjective prong of sham transaction

analysis into the question of whether a taxpayer receives QEZE benefits.[7] These amendments clearly indicate the Legislature's intent to deny benefits to taxpayers that seek to acquire tax preference under the Empire Zones Program without providing any of the intended benefits to their communities (***see*** General Municipal Law § 956).[8]

This case presents the question of whether petitioner has adduced sufficient evidence to prove that its reorganization was not, in fact, a sham transaction to acquire tax preferences. At issue are QEZE real property tax credits, which are "a particularized species of exemption from taxation" (***Matter of Mallinckrodt***, Tax Appeals Tribunal, November 12, 1992). As it is the party seeking the exemption, petitioner bears the burden of proving clear entitlement to this exemption (***see Matter of Marriott Family Rests. v. Tax Appeals Trib.***, 174 AD2d 805 [1991], ***lv denied*** 78 NY2d 863 [1991]). In the context of the foregoing statute, petitioner must come forward with clear and convincing evidence that its formation of GMC 2 was not solely to acquire QEZE benefits and had a valid business purpose under Tax Law § 208(9)(o)(1)(B).

The inquiry into whether a valid business purpose existed at the time of action "involves a subjective analysis of the taxpayer's intent" (***Winn-Dixie Stores v. Commissioner***, 113 TC 254, 280 [1999], ***affirmed*** 254 F3d 1313 [2001], ***cert denied*** 535 US 986 [2002]; ***Gregory v. Helvering***, 293 US 465 [1935]). We note that in cases addressing valid business purpose "the

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[7] The sham-transaction doctrine provides, generally, that actions cease to merit tax respect when they have "no economic effect" other than the creation of tax preferences (***Kirchman v. Commissioner***, 862 F2d 1486, 1492 [11th Cir 1989]). For further discussion on the objective test (economic substance) and subjective test (valid business purpose), ***see Countryside Limited Partnership v. Commissioner***, TC Memo 2008-3 at fn 20 (***see also ACM Partnership v. Commissioner***, 157 F3d 231 [1998] ***cert denied*** 526 US 1017 [1999]).

[8] We note that the language of Tax Law § 14(j)(4)(B) distinguishes this sham transaction analysis from cases where both the subjective prong (valid business purpose) and objective prong (economic substance) are present (***see Matter of Sherwin-Williams Co.***, Tax Appeals Tribunal, June 5, 2003, ***affirmed*** 12 AD3d 112 [2004], ***lv denied*** 4 NY3d 709 [2005]; ***Matter of The Talbots, Inc.***, Tax Appeals Tribunal, September 8, 2008).

question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended" (***Gregory v. Helvering, supra,*** at 469; ***see also In re CM Holdings***, 301 F3d 96 [2002]).[9]

Applying these principles to QEZE tax preferences, Tax Law § 14(j)(4)(B) clearly indicates that the Legislature structured this particular valid business purpose analysis such that tax considerations may influence a taxpayer's business decisions; however, the primary motivation for the business activity may not be the tax benefits but must be consistent with the intent expressed within General Municipal Law § 956 (i.e. economic revitalization through private investment and job creation). Determining the motivation of a business activity or transaction is, necessarily, a fact-intensive inquiry.

The Administrative Law Judge made his determination based upon his review of the record, which contains minutes of corporate meetings leading up to the decision to reorganize the corporate structure, correspondence related to the decision, as well as the testimony from officers. As discussed above (***see*** Findings of Fact above), these documents indicate that the idea of reorganization arose in 1998 with petitioner's business strategy of expanding by acquiring new businesses. They also indicate that the Yonkers facility had liabilities from its use of the Croton Point Landfill, which, in their vertical structure, would expose subordinate companies to liability. The actual decision to reorganize GMC 1 came in the form a resolution on June 16, 1998, and without contemplation of QEZE benefits. Subsequent minutes from meetings in 1998, 1999 and 2000, reflect discussion among the board of how best to restructure the company for acquisitions;

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[9] We agree with the opinion expressed by the Third Circuit in ***In re CM Holdings***:
"If Congress intends to encourage an activity, and to use taxpayers' desire to avoid taxes as a means to do it, then a subjective motive of tax avoidance is permissible. But to engage in an activity solely for the purpose of avoiding taxes where that is not the statute's goal is to conduct an economic sham" (***In re CM Holdings, supra*** at 106).

however, these contain no mention of the empire zone credits.

The minutes from 2001 through 2002 paint a bleak economic picture, with the company missing sales expectations and still exposed to liability from the Croton Point Landfill. The record shows that petitioner's outside consulting firm advised the board to move ahead with reorganization to take advantage of the QEZE program before amendments took place. In its deliberations, the board noted that the purpose of the program was to keep businesses in Yonkers, as opposed to relocating away from the area. On September 11, 2002, the board resolved to reorganize and, subsequently, formed GMC 2 on December 30, 2002, and received retroactive QEZE status to July 31, 2002.

The Administrative Law Judge reviewed the record and found that petitioner met the requirements of Tax Law § 14(j)(4)(B). He concluded that the reorganization resulted in a meaningful change to the company's economic position because it returned to profitability. He also found that petitioner's formation of GMC 2 met the standard in Tax Law § 14(j)(4)(B) and listed three reasons: (1) to facilitate the acquisition of other companies in the industry; (2) to increase market share and sales volume; and (3) to isolate potential liability arising out of the use of the Croton Point Landfill.

The Division submits that petitioner is, in fact, a "shirt changer," and that the Administrative Law Judge incorrectly applied the standards in Tax Law § 14(j)(4)(B) and Tax Law § 208(9)(o)(1)(B). The Division claims that petitioner's purposes are mere window dressings (***Shriver v. Commissioner***, 899 F2d 724 [1990]), and claims that the reorganization and formation of GMC 2 resulted in no meaningful change to petitioner's economic position. It submits that the motivation for petitioner's reorganization is exactly the type proscribed by the

2002 and 2005 reforms to the Empire Zone Program. We do not agree.

We affirm the determination of the Administrative Law Judge because it is substantially supported by the record. Our review is heavily influenced by ***Gregory v. Helvering, supra***, wherein the Court stated:

> Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? (***Gregory v. Helvering, supra*** at 469).

In ***Gregory v. Helvering, supra***, the Court found that reorganization had no business purpose; however, we are presented with opposite facts. We need not engage in putting aside the question of tax motive because, herein, petitioner elected to reorganize prior to becoming aware of the QEZE tax benefits. The record reveals that its business purpose was to better facilitate acquisitions and isolate individual companies' liabilities from one another. It is apparent that petitioner resolved to change its structure to mirror its change in business philosophy (i.e. market capture through acquisitions). We find that the Administrative Law Judge properly found meaningful economic change given the increased profits at GMC 2, and the resulting actual expansion into the metal market through acquisitions in other states.

We consider petitioner's reorganization and formation of GMC 2 to be consistent with the legislative intent of the Empire Zone Program. The record reflects declining economic performance in the wake of the September 11, 2001 attacks and resulting recession in the manufacturing industry. Rather than relocate its business, which is alluded to in petitioner's corporate minutes, the QEZE program provided petitioner with an incentive to stay in Yonkers by merely doing what it had previously resolved to do. The Administrative Law Judge properly concluded that petitioner met its burden of proof and granted the refund of QEZE real property

tax credits.

We now turn to the Division's argument that the determination should be reversed because the Administrative Law Judge erroneously considered evidence from prior to July 31, 2002, as relevant. The Division correctly notes that valid business purpose language in Tax Law § 14(j)(4)(B) is a component of the sham transaction doctrine and properly cites to jurisprudence stemming from ***Gregory v. Helvering, supra***; s***ee also Rice's Toyota World v. Commissioner,*** 752 F2d 89 [1985]; ***Frank Lyon Co. v. United States***, 435 US 561 [1978]). Citing to ***Winn-Dixie Stores v. Commissioner, supra***, the Division contends that the Administrative Law Judge erred by considering elements in the record, both prior to and after July 31, 2002. We disagree.

Our charge herein is to ascertain the subjective intent of a taxpayer motivating the business activity or transaction (***Gregory v. Helvering, supra***). We do agree that contemporaneous documentation bears greater relevance than after-the-fact rationalizations (***see Winn-Dixie Stores v. Commissioner, supra***; ***In re CM Holdings, supra***; ***Frank Lyon Co v. United States, supra***). However, in our review of the sham transaction jurisprudence, we could find no case that would support excluding evidence that is contemporaneous to the initial business decision, the subsequent deliberation, or eventual execution of business activity or transaction. In our view, such documentation reflects the interests of a taxpayer during the contemplation of the questioned activity.

We find no merit to the Division's argument that these documents should be excluded because they were not generated on July 31, 2002. The record includes evidence from prior to the initial decision to reorganize in 1998 through 2005. Focusing on the correspondence and corporate minutes from 1998 through 2002, these documents reveal the considerations and

motivations behind petitioner's decision to reorganize and form GMC 2. The reality is that petitioner's board was authorized to reorganize in 1998 and continued to deliberate the form until the formation of GMC 2. As such, this has probative value relevant to the subject business activity because it contains "the motives of the taxpayer" when it entered into the reorganization process (***Matter of The Sherwin-Williams Co., supra***). Accordingly, we hold that the Administrative Law Judge properly considered these documents because they were relevant to the valid business purpose inquiry.

We also reject the Division's argument that the Administrative Law Judge made erroneous evaluations of credibility and weight. The Division introduced no evidence challenging the credibility of either the documents or the witnesses. Rather, the Division argues that all of petitioner's submissions should be accorded no weight because they were submitted after the audit period. It also argues that the testimony should be deemed irrelevant because the witnesses were employed by GMC 2.

Although not bound by the findings below (***Matter of Spallina***, Tax Appeals Tribunal, February 27, 1992), the conclusions of the trier of fact are entitled to deference (***see Matter of 677 New Loudon Corp. v. Tax Appeals Trib.***, ___ NYS2d ___ , 2011 [slip op 04787 (3d Dept 2011)], ***citing Pearson v. Catherwood***, 27 AD2d 598 (1966) ["Credibility determinations, including the weight to be accorded to an expert's testimony, are matters that lie 'solely within the province of the administrative factfinder.'"] when supported by the record or are not otherwise erroneous.

The Administrative Law Judge considered the documents and relevant testimony and found them to be credible. As previously noted, the determination of petitioner's motivations for

a business activity is a fact-intensive inquiry that turns on evaluations of credibility and weight. Our review shows that the Administrative Law Judge's evaluations are supported by the weight of the evidence. We note that the mere fact that the finder of fact could have found otherwise does not present valid grounds for reversal (***see generally Anderson v. Bessemer City***, 470 US 564, 574 [1985] ["(w)here there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous"]; ***Reading v. Commissioner***, 614 F2d 159 [1980]). We defer to the Administrative Law Judge because we can find no error. The record lacks any evidence that would merit reconsideration of these findings. Accordingly, we reject the Division's request to reverse the determination of the Administrative Law Judge.

We have examined the Division's remaining contentions, to the extent not specifically addressed, and find them to be lacking in merit or not requiring a different result.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

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

3. The petition of the Division of Taxation is denied; and

4. The Division of Taxation is directed to refund to petitioner a Qualified Empire Zone Enterprise real property tax credit in the amount of $106,606.00 plus applicable interest.

DATED: Troy, New York
July 7, 2011

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

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner