STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ADOLPH FALSO AND BARBARA E. FALSO	:	DECISION DTA NO. 823587
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2006 and 2007.	:	

Petitioners, Adolph Falso and Barbara E. Falso, filed an exception to the determination of the Administrative Law Judge issued on June 21, 2012. Petitioners appeared by Hiscock & Barclay, LLP (Kevin R. McAuliffe, Esq., and David G. Burch, Jr., Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on December 5, 2012 in Albany, New York.

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

ISSUES

I. Whether the Division of Taxation properly determined that the payments in lieu of taxes paid by Falso Holding Co., LLC, were not eligible real property taxes pursuant to Tax Law § 15 (e).

II. Whether the Division of Taxation properly determined that petitioners were ineligible to claim a qualified empire zone enterprise credit for real property taxes based upon its

determination that Seneca Data Distributors, Inc., did not have a valid business purpose and was formed solely to gain empire zone tax benefits.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "2," which has been substantially incorporated into finding of fact "1." We have modified findings of fact "1," "4" through "8," and "12." We have also made additional findings of fact. The Administrative Law Judge's findings of fact, the modified findings of fact, and the additional findings of fact are set forth below.

We modify finding of fact "1" of the Administrative Law Judge's determination to read as follows:

> Seneca Data Distributors, Inc. (Seneca Data 1)[1] was a New York corporation that was formed on November 7, 1980.[2] SDD Holding, Inc. (Seneca Data 2)[3] is a New York S corporation, formed on July 10, 2002 with a sole shareholder, Adolph Falso. All income attributes of Seneca Data 2 flow through the S corporation to Mr. Falso's personal income tax returns. Seneca Data 2 was certified eligible to receive qualified empire zone enterprise (QEZE) benefits prior to August 1, 2002. By way of a reorganization, effective October 1, 2002, Seneca Data 1 merged into Seneca Data 2.[4, 5]

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[1] The Administrative Law Judge determination referred to this entity as "Predecessor Corporation." For purposes of this decision, the entity shall be referred to as "Seneca Data 1."

[2] This is noted in the Plan of Agreement of Merger of Seneca Data Distributors, Inc. into SDD Holdings, Inc.

[3] The exhibits in the record indicate that the company formed on July 10, 2002 was legally named "SDD Holdings, Inc." However, this company soon thereafter changed its legal name to "Seneca Data Distributors, Inc." (the exact same former legal name of Seneca Data 1) on October 1, 2002. The Administrative Law Judge determination referred to this entity as "Seneca Data." For purposes of this decision, the entity shall be referred to as "Seneca Data 2."

[4] The Certificate of Merger filed with the New York State Department of State indicates that the effective date of the merger was to be October 1, 2002.

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

Seneca Data 1's primary focus through the late 1990s was the distribution of computer products manufactured by other companies such as Okidata and Acer America.

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

> The management team of Seneca Data 1 consisted of: Kevin Conley, president; petitioner, Adolph Falso, owner; Jon Verbeck, chief financial officer; Brian Garrett, vice president of sales and marketing; and Doug Phillips, vice president of service. This management team remained in place upon the creation of Seneca Data 2. As reflected in the Plan of Merger Agreement, Seneca Data 2 had the exact same corporate directors as Seneca Data 1.[6]

We modify finding of fact "5" of the Administrative Law Judge's determination to read as follows:

> Mr. Conley prepared a memorandum for the management team, dated August 31, 1998 that identified various aspects of the operations of Seneca Data 1. The memo noted that Seneca Data 1's sales and gross profits had increased from 1997 to 1998 but that if expenses increased at a similar rate as they had in the past, the company would experience certain reduced profit margins in the future. The memo also noted that certain products sold by Seneca Data 1 had lower profit margins than other products Seneca Data 1 sold. Along with certain other recommendations, the memo noted that if the company was looking to change its business model, it should focus on increasing the sales of the more profitable products it was already selling, while attempting to reduce the expenses associated with the sale of its less profitable products. There is no reference in the memo to the creation of either a new corporate entity, or a change from being a distributor to being a manufacturer. When drafting his memorandum, Mr. Conley had not heard of the Empire Zones program. While Mr. Conley and the rest of the management team discussed the issues and recommendations set forth in the memorandum, no action was taken at that time.[7]

We modify finding of fact "6" of the Administrative Law Judge's determination to read as follows:

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

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

Petitioners submitted certain documentation addressing the merger of Seneca Data 1 into Seneca Data 2. Namely, petitioners submitted the relevant Merger Agreement for Seneca Data 1 and Seneca Data 2, the new corporate bylaws, and corporate financial statements for the year of, and those following, the reorganization.[8]

We modify finding of fact "7" of the Administrative Law Judge's determination to read as follows:

Seneca Data 1 entered into a "Payment in Lieu of Tax Agreement" (PILOT Agreement),[9] dated September 1, 1999, with the Onondaga County Industrial Development Agency (Onondaga IDA),[10] which agreement governed the payments in lieu of real property taxes that would otherwise have been assessed against the corporation's real property on Round Pond Road (the Property). The express terms of the PILOT Agreement specify that it can be amended.[11]

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

On October 1, 2002, Seneca Data 1, Seneca Data 2 and Falso Holding Company, LLC (Falso Holding) entered into an agreement titled "Reaffirmation Agreement." Among other items, this agreement confirmed the previous transfer of the obligation to pay all real property taxes, and other certain obligations,[12] from Seneca Data 1 to Falso Holding. The Reaffirmation Agreement also confirmed that the PILOT Agreement was assigned from Seneca Data 1 to Falso Holding.[13]

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

[9] The Administrative Law Judge determination referred to this agreement as the "Round Pond Road PILOT" or the "PILOT agreement." For purposes of this decision, the agreement shall be referred to as "PILOT Agreement."

[10] The Administrative Law Judge determination referred to this entity as the "IDA." For purposes of this decision, the entity shall be referred to as "Onondaga IDA."

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

[12] The Reaffirmation Agreement specified that the transfer of obligations to pay all real property taxes from Seneca Data 1 to Falso Holding was initially performed via an Amendment to Lease Agreement. A copy of the subject Amendment to Lease Agreement was included as an incorporated exhibit attached to the Reaffirmation Agreement.

[13] The Reaffirmation Agreement specified that the transfer of obligations under the relevant PILOT Agreement from Seneca Data 1 to Falso Holding was initially performed via an Assignment and Assumption of Payment in Lieu of Tax Agreement between Seneca Data 1 and Falso Holding. A copy of the subject Assignment and Assumption of Payment in Lieu of Tax Agreement was included as an incorporated exhibit attached to the

On the signatory page, under the heading "ACCEPTED AND CONSENTED:," a representative of the Onondaga IDA executed the Reaffirmation Agreement. The Reaffirmation Agreement was also executed by Seneca Data 1, Seneca Data 2 and Falso Holding.[14]

The Division of Taxation (Division) conducted a desk audit of Seneca Data 2 and an audit of the personal income tax returns of petitioners, pursuant to which the Division determined that Seneca Data 2 was not formed for a valid business purpose pursuant to Tax Law § 14 (j) and issued Notices of Deficiency L-033002753 and L-033002752, dated January 14, 2010, to petitioners for the years 2006 and 2007, respectively.

The Division's auditor assigned to this case reviewed Seneca Data 2's tax returns for the years 2002 through 2007, as well as the tax return for the tax year ending September 30, 2002, for the Seneca Data 1. The auditor requested several documents, such as internal memoranda, e-mails or written correspondence that could show why the reorganization was undertaken. Although petitioners asserted that a meeting of the board of directors was held to consider a merger, no meeting minutes were produced. The auditor asserted that petitioners had failed to provide sufficient proof that the reorganization was performed for valid business purposes. The auditor also concluded that Seneca Data 2 was formed to maximize tax incentives and, as such, was not formed for a valid business purpose. Accordingly, the auditor issued the Notices of Deficiency to petitioners reflecting those conclusions.

In addition to Empire Zone benefits claimed through Seneca Data 2, Mr. Falso also claimed Empire Zone benefits, including the real property tax credit, through another certified Empire Zone enterprise, Falso Holding.

Reaffirmation Agreement.

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

We modify finding of fact "12" of the Administrative Law Judge's determination to read as follows:

> The amount of the real property tax credit claimed by petitioners on their 2006 and 2007 income tax returns was included as part of the sums sought in the Notices of Deficiency sent to petitioners for those tax years. The Division concluded that since Falso Holding was not a party to the written agreement with the Onondaga IDA, as is required by Tax Law § 15, Falso Holding was not eligible to claim the real property tax credit. The Division did not inform petitioners of its basis for this portion of the deficiency until approximately one week before the hearing.[15]

We also make the following additional findings of fact:

Seneca Data 2' s audited Financial Statements for 2002 and 2003, and the related Independent Auditor's Report prepared by Fust Charles Chambers, LLP,[16] specifically addressed the 2002 reorganization by stating in the notes to the Financial Statements, in relevant part:

> "Effective October 1, 2002, [Seneca Data 1] merged into [Seneca Data 2]. [Seneca Data 2] was wholly owned by [Seneca Data 1's] sole stockholder. Accordingly, the transaction has been accounted for at book value and has been presented in the accompanying financial statements as if the pooling of interests method had been used.
>
> Concurrent with the merger, [Seneca Data 2], the surviving entity, changed its name to [Seneca Data 1's legal name]. Also, concurrent with the merger, treasury stock previously held by [Seneca Data 1] was retired, The par value of [Seneca Data 2] is $.01 per common share. The no par value common stock of [Seneca Data 1] was retired."

The relevant New York S Corporation Franchise Tax Return (form CT-3-S) filed by Seneca Data 2 included a statement made pursuant to Treas Reg § 1.368-3 (a) (1) that articulated the purposes for the relevant 2002 reorganization as follows:

> "The purpose [*sic*] of the reorganization were to: (1) reorganize the corporate structure by forming a new corporation governed by New York law, in order to benefit from the flexibility, predictability, and other legal advantages available under New York law; and (2) enable the corporation to maximize economic

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

[16] The financial statements and related notes thereto were appropriately prepared by and are the responsibility of Seneca Data 2's corporate management.

development incentives and benefits under state law. Both of these reasons are of substantial economic and business value to the corporation and its shareholder."

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge reviewed the applicable provisions of the Economic Development Zone Program including the 2002 amendments to Tax Law § 15. The Administrative Law Judge noted the respective parties' obligations under the PILOT Agreement, and concluded that the Onondaga IDA was not a party to the Reaffirmation Agreement. As such, the Administrative Law Judge determined that petitioners were precluded from receiving certain credits at issue.

Next, the Administrative Law Judge analyzed application of the "valid business purpose" test set forth in Tax Law § 14 (former [j] [4] [B]) and concluded that petitioners failed to meet their burden of proof establishing that the reorganization of Seneca Data 1 into Seneca Data 2 was accomplished for a valid business purpose and not merely to gain tax incentives.

Accordingly, the Administrative Law Judge upheld the Notices of Deficiency.

ARGUMENTS ON EXCEPTION

On exception, petitioners argue that they should be eligible to receive certain credits at issue, because there is a sufficient written arrangement between the Onondaga IDA and Falso Holding. Petitioners also assert that Seneca Data 1 and Seneca Data 2 are significantly different entities and, therefore, the "valid business purpose" test does not apply to the required analysis. In the alternative, petitioners argue that if the "valid business purpose" test does apply, then the August 31, 1998 memo combined with petitioners' witnesses' testimony, establish that Seneca Data 2 was in fact formed for a valid business purpose, aside from maximizing tax benefits.

In response to petitioners' argument that they should be eligible to receive certain credits at issue, the Division argues that there was no written agreement between the Onondaga IDA and Falso Holding, as required by the relevant law. With regard to application of the "valid business purpose" test, the Division argues that petitioners failed to provide any contemporaneous documentation pertaining to the reorganization of Seneca Data 1 into Seneca Data 2. Therefore, the Division argues that petitioners have failed to establish that Seneca Data 2 was established for a "valid business purpose" and seeks to have the Notices of Deficiency upheld.

OPINION

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

Under Article 18-B, certain business taxpayers can be certified as QEZEs (***see*** General Municipal Law § 958; Tax Law § 14 [a]). A taxpayer must meet certain qualifications to be certified as a QEZE, including an employment test (***see*** Tax Law § 14 [a]). For businesses certified as QEZEs prior to April 1, 2005, as is the case here, this test compares the employment number of a qualified business in its base period against its employment number in the years being tested (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 eligible real property taxes set against personal income tax under Article 22 (Tax Law § 15 [a]; 16 [a]).

Tax Law § 15 (e), as first enacted, defined "eligible real property taxes" to mean "taxes imposed on real property which is owned by the taxpayer and located in economic development

zones with respect to which the taxpayer is certified pursuant to article eighteen-B of the general municipal law for the taxable year" (***see*** L 2000, ch 63, effective May 15, 2000).

In 2002, Tax Law § 15 (e) and its definition of "eligible real property taxes" was amended. Specifically, the term "taxpayer" therein was changed to "QEZE," and a requirement was added that the taxes become a lien on the real property during a taxable year in which the owner of the real property is both certified pursuant to article eighteen-B of the general municipal law and a qualified empire zone enterprise. In addition, the definition of the payments that comprised "eligible real property taxes" for purposes of the credit was expanded as follows:

> "In addition, the term 'eligible real property taxes' includes payments in lieu of taxes made by the QEZE to the state, a municipal corporation or a public benefit corporation pursuant to a written agreement entered into between the QEZE and the state, municipal corporation, or public benefit corporation."

By this amendment to Tax Law § 15 (e), the Legislature recognized that PILOT payments made by a QEZE pursuant to a written agreement, constituted "eligible real property taxes" (***see*** L 2002, ch 85, effective May 29, 2000).

In this case, the parties to the original PILOT Agreement, dated September 1, 1999, were the Onondaga IDA and Seneca Data 1. Subsequently, on or about October 1, 2002, Seneca Data 1, Seneca Data 2 and Falso Holding entered into the Reaffirmation Agreement, which confirmed, among other things, the assignment and transfer of the obligation to pay all real property taxes from Seneca Data 1 to Falso Holding. The Reaffirmation Agreement also confirmed that all the obligations and duties under the relevant PILOT Agreement were assigned by Seneca Data 1 to Falso Holding.

In reviewing the terms of the PILOT Agreement, executed by the Onondaga IDA and Seneca Data 1, it is clear that under the terms of that agreement, only Seneca Data 1 is obligated

to make the PILOT payments. Falso Holding's obligation to make the PILOT payments arises under a separate Assignment and Assumption of Payment in Lieu of Tax Agreement and a separate Amendment to Lease Agreement, the general terms of which were confirmed in the body of the Reaffirmation Agreement. The Division's argues that the Onondaga IDA was not a party to the Assignment and Assumption of Payment in Lieu of Tax Agreement, the Amendment to Lease Agreement, or the Reaffirmation Agreement. The Division asserts that this precludes petitioners from potentially receiving credits at issue.[17] We reject this argument. The Onondaga IDA executed the Reaffirmation Agreement on the signature page under the heading "ACCEPTED AND CONSENTED." The Reaffirmation Agreement was also separately signed by Seneca Data 1, Seneca Data 2 and Falso Holding. The Reaffirmation Agreement, which pre-dates the tax years petitioned, reiterated and confirmed the transfer of the duty to pay certain payment in lieu of tax obligations under the PILOT Agreement from Seneca Data 1 to Falso Holding.

We note that, in general, a party whose signature appears on a contract, the text of which contains nothing to indicate that it is a party to the contract, is not bound to the terms of the contract (***New Amsterdam Cas. Co. v Mobinco Brokerage Co., Inc.***, 219 App Div 486 [1927]). However, New York recognizes exceptions to the general rule, and there are circumstances where a person signing a contact, but not mentioned in the body therein, is considered a party to the contract (***id.***). "This is considered to be an application of the rule which requires effect to be given to all parts of a written instrument, where that is possible" (***Esselstyn v McDonald***, 98 App

[17] The Division's argument in opposition to granting these particular credits, is that Falso Holding was not a party to a written agreement with the Onondaga IDA. During the hearing, the Division's auditor testified that this was in fact the case (Hearing Transcript at pages 45-46). In the absence of a more detailed record, we limit our analysis to that sole argument with regard to such credits.

Div 197 [1904]. In this case, not only did the Onondaga IDA sign the Reaffirmation Agreement, it did so under a heading indicating that it was "accepting and consenting" to all of the terms of the Reaffirmation Agreement. The circumstances in this case are much more compelling than those where an entity's signature merely appears at the end of a contract with no reference as to why the party signed the agreement. The facts of this case sufficiently meet the requirement that the arrangement be made "pursuant to a written agreement entered into between the QEZE and the state, municipal corporation, or public benefit corporation."

On exception, petitioners also argue that Seneca Data 2 substantially differs in operations from Seneca Data 1 and, therefore the transaction at issue is not subject to the "valid business purpose" requirements of Section 14 (j) (4) of the Tax Law. Petitioners assert, and the Division does not challenge, that under Section 14 of the Tax Law, an entity such as Seneca Data 2, certified prior to August 1, 2002, passes the "valid business purpose" test if it qualifies as a new business under Section 14 (j). Tax Law Section 14 (j) (1) provides:

> "New business. (1) A new business shall include any corporation, except a corporation which is substantially similar in operation and in ownership to a business entity (or entities) taxable, or previously taxable, under section one hundred eighty-three, one hundred eighty-four, one hundred eighty-five or one hundred eighty-six of article nine; article nine-A, article thirty-two or thirty-three of this chapter; article twenty-three of this chapter or which would have been subject to tax under such article twenty-three (as such article was in effect on January first, nineteen hundred eighty) or the income (or losses) of which is (or was) includable under article twenty-two of this chapter."

Petitioners assert that if Seneca Data 1 and Seneca Data 2 are found not to be substantially similar in operation, the provisions of Tax Law Section 14 (j) (4) (B) that require application of the valid business purpose test do not apply. The Division does not challenge this assertion, but rather claims that Seneca Data 1 and Seneca Data 2 are substantially similar, and as

such, the valid business purpose test applies. Based upon the record, we conclude that petitioners have failed to meet their burden of proof establishing their assertion that Seneca Data 1 and Seneca Data 2 were not substantially similar at the time of the reorganization.

Petitioners claim that Seneca Data 1 and Seneca Data 2 are not substantially similar because Seneca Data 1 was a distributor of computer products manufactured by other companies, whereas Seneca Data 2 is a manufacturing business that makes and sells its own highly-customized products. Relying on the testimony of petitioners' witnesses, petitioners assert that "[t]here wasn't a piece [of Seneca Data 1's operations] that was left out" of the changes implemented in the reorganization from Seneca Data 1 to Seneca Data 2. Petitioners' witnesses assert that the significant change in operations included hiring new people into leadership positions, putting new people into sales and product support positions, implementing a new compensation plan, and creating new marketing materials. Petitioners explain that although the ownership between the two companies remained similar, the entities [Seneca Data 1 and Seneca Data 2] "were vastly different in operation." Petitioners presented the testimony of the corporate manager, Mr. Kevin Conley, to demonstrate that Seneca Data 2 was substantially different from Seneca Data 1. However, Mr. Conley's testimony regarding who was hired and when, along with other assertions, was general in nature and vague and did not articulate with sufficient specifics exactly what had changed and when such changes were implemented.[18] Mr. Conley stressed that Seneca Data 1 and Seneca Data 2 are so different because Seneca Data 1 was a distributor, whereas Seneca Data 2 is a manufacturer.

[18] Furthermore, we note that many, if not most, of Mr. Conley's assertions were not supported with documentary evidence. Although such is not always required, it can be very useful in accurately determining or verifying asserted facts.

In this regard, we first note that Section 3, the "Effects of Merger" section, of the Merger Agreement recognizes that Seneca Data 2 would succeed to all of Seneca Data 1's liabilities and assets.[19] The record is not clear regarding whether, immediately preceding the October 2002 merger between the two entities, Seneca Data 2 had any assets or liabilities of its own to contribute to the merged entity. Such appears very unlikely, given the circumstances and record as presented. Accordingly, in essence, Seneca Data 2 was a carbon copy of assets and liabilities of Seneca Data 1.

We also note that at virtually the exact same time that the operating entity, Seneca Data 1, merged into the new and "vastly different" entity, Seneca Data 2, Seneca Data 2 changed its name back to Seneca Data 1's previous legal name. Furthermore, based upon the fact that the directors and corporate officers of Seneca Data 1 and Seneca Data 2 remained the same following the reorganization, the reorganization does not appear to have materially impacted the management of the different companies or the operating entity's appearance to third parties.

Moreover, Seneca Data 2's audited Financial Statements for 2002 and 2003 specifically addressed the reorganization. However, we note that management's comments on the reorganization do not seem to express any emphasis on the alleged material significance of the transaction.

In addition, Seneca Data 2's Financial Statements for 2002 and 2003, 2004 and 2005, and 2006 and 2007 each state that Seneca Data 2's operations consisted of operations as "a wholesale distributor and service center for computer products." There is no reference whatsoever to the presence of manufacturing, or other operations for those years. These financial statements do not

[19] The attachments to Seneca Data 2's 2002 form CT-3-S, New York S Corporation Franchise Tax Return, confirms this fact.

recognize any material change in operations from how Seneca Data 1 operated, or what business Seneca Data 1 conducted, compared to those of Seneca Data 2.

Seneca Data 2's Financial Statements for 2008 and 2009 recognize that the sole shareholder of Seneca Data 2 became the primary owner of a new company, Revonate Manufacturing, LLC (Revonate), which was formed in February of 2008, for the purpose of manufacturing computer products. The Seneca Data 2 Financial Statements for 2008 and 2009 recognize that the companies' operations[20] now included those of "a computer manufacturer, distributor and a value added technology partner . . . ."

Thus, even though petitioners assert that the 2002 reorganization materially changed the company's business model from a distribution company to a manufacturing company, the relevant financial statements produced by Seneca Data 2's management, and audited by an independent accounting firm, do not recognize any such monumental changes at the time of the reorganization. The relevant financial statements do not recognize manufacturing as an important business component of Seneca Data 2's operations until 2008, approximately six years after the merger. The recognition of manufacturing as an important and substantial business component of Seneca Data 2's operations appears to have been the direct result of the acquisition of a new company, Revonate, in 2008, rather than a result of the 2002 reorganization.[21]

Petitioners assert that, in addition to the testimony of a corporate manager, the 1998 memorandum is proof of the proposition that Seneca Data 2 was substantially different from Seneca Data 1 and was created for a valid business purpose. First, we note that nowhere in the

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[20] Seneca Data 2's financial statements were presented consolidated with the operations of Revonate.

[21] Petitioners' counsel attempts to dilute the relevance and significance of the audited financial statements. We are not inclined to disregard audited financial statements as petitioners' counsel desires us to do.

1998 memorandum is the creation of Seneca Data 2 or a reorganization like the one carried out in 2002 mentioned. Furthermore, the date of the 1998 memorandum (approximately four years before the merger) in light of its content, appears tenuously connected to the 2002 merger. Petitioners never adequately explained how the 2002 reorganization was a necessary or integral part of what was advanced by the 1998 memorandum. The 1998 memorandum is not a factual statement regarding how Seneca Data 2's operations differed from Seneca Data 1's operations. Rather, it is a proposal that certain changes in business operations should be considered in the future. Our analysis at this juncture is whether or not Seneca Data 2's operations were substantially similar to Seneca Data 1's operations.

The 1998 memorandum and the testimony of the corporate manager do not outweigh the weight of the disclosures contained in the audited corporate financial statements and the disclosures made in the relevant tax returns, as discussed below, which do not indicate any immediate material changes between the entities.

Petitioners fail to establish that significant changes between Seneca Data 1's and Seneca Data 2's operations occurred within a close time frame of the reorganization. There is no specific time frame prescribed by law to guide the analysis of whether a predecessor company is significantly different from a successor company. However, it seems appropriate, given the context of the relevant statute, that more material changes between Seneca Data 1 and Seneca Data 2 would have been clearly evident in a period of fewer than six years after a reorganization. We note that the relevant statute was written in the context of an immediate analysis of whether a valid business purpose existed for the transaction at the time of the transaction. Accordingly, it seems appropriate that the analysis of whether the predecessor and successor companies were substantially similar in operation likewise requires a more immediate analysis. Petitioners'

argument, that the relevant legal analysis should compare the predecessor company to a successor company that has existed and been in business for several years after the relevant reorganization, appears misplaced.

The gradual changes in Seneca Data 2's operations over the years (prior to the acquisition of Revonate in 2008) were not immediate or significant changes. Moreover, as discussed below, it appears that the 2002 merger transaction was performed solely to gain tax benefits and not to change the businesses' underlying operations.

Next, we address whether the 2002 reorganization that created Seneca Data 2 had a valid business purpose within the meaning and intent of Tax Law § 14. After the year 2000, the Legislature identified abuses of the Empire Zones program by a process known as "shirt changing," whereby an existing business would reorganize into a new 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.

Commencing with tax years beginning on or after January 1, 2005, chapter 161 of the Laws of 2005 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."

Based upon the record as presented, in order for Seneca Data 2 to receive certain benefits at issue, Seneca Date 2 must meet the new business "valid business purpose" test, which, as set forth in Tax Law § 14 (former [j] [4] [B]), provides 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) defines "valid business purpose" as follows:

> "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."

Accordingly, in order to establish entitlement to the benefits and tax credits sought for the years at issue, obtaining QEZE benefits cannot have been the primary purpose for the 2002 reorganization.

In ***Matter of Graphite Metallizing Holdings*** (Tax Appeals Tribunal, July 7, 2011), we noted that:

> "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]) . . . .
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> 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 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; citations omitted)."

In reviewing the record for evidence that existed at the time of the reorganization, the Administrative Law Judge appropriately pointed to exhibit "L," the initial New York S Corporation Franchise Tax Return (form CT-3-S) filed by Seneca Data 2. Attached to the return is a statement made pursuant to Treas Reg § 1.368-3 (a) (1) that describes the purposes of the relevant reorganization as follows:

> "The purpose [*sic*] of the reorganization were to: (1) reorganize the corporate structure by forming a new corporation governed by New York law, in order to benefit from the flexibility, predictability, and other legal advantages available under New York law; and (2) enable the corporation to maximize economic development incentives and benefits under state law. Both of these reasons are of substantial economic and business value to the corporation and its shareholder."[22]

We find this statement telling. As the Administrative Law Judge recognized, the first claimed purpose, to reorganize as a New York State corporation to gain access to the benefits of being incorporated in New York was an illusory goal, given the fact that Seneca Data 1 was *already* a New York corporation. The only other asserted purpose for the relevant reorganization appears to be the attainment of QEZE benefits. Although we recognize that this alone may be a valid business purpose for a reorganization under New York's business corporation law, such is not considered a sufficient valid business purpose to receive QEZE benefits under the relevant tax law. The other telling evidence prepared at a time close to the reorganization were the audited financial statements, which, as reviewed above, do not indicate that there was any significant business reason to the 2002 reorganization. On exception, petitioners still fail to convince us why the 2002 reorganization was necessary to accommodate their desire to focus on manufacturing.

We also note that the auditor on this case requested several potentially relevant documents from petitioners, such as internal memoranda, e-mails and written correspondence that could show why the reorganization was undertaken. As the Administrative Law Judge noted, no meeting minutes or other additional requested documentation was produced. Although such is not necessarily determinative of the matter, petitioners failure to produce any further relevant contemporaneously prepared business records supporting their position (although

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[22] It appears as though the original statement filed with Seneca Data 2's federal tax return was signed under penalties of perjury by the corporate chief financial officer.

requested to do so) further buttresses our conclusion that petitioners have failed to establish an appropriate business purpose for the 2002 reorganization.

At the hearing, petitioners offered the testimony of Mr. Kevin Conley to demonstrate a valid business purpose for the reorganization. His testimony addressed the issue regarding changes made to the company in the years following the merger. For instance, Mr. Conley explained that their business model was not sustainable and that certain changes needed to be made. However, we agree with the Administrative Law Judge that Mr. Conley's general explanations did not rise to the level of sufficient proof required to find that the reorganization was accomplished for a valid business purpose. There was never an explanation as to why the reorganization was required in order to accomplish any of the goals set for the company. Companies can and often do make the changes Mr. Conley addressed, without reorganizing into a new entity. Moreover, as Seneca Data's financial statements and other evidence indicates, for several years following the reorganization, the "new" entity appears to have been virtually a copy of the earlier entity. We need not restate our analysis above or that performed by the Administrative Law Judge in this regard. We agree with the Administrative Law Judge that petitioners failed to sustain their burden of proof that the reorganization was accomplished for a valid business purpose and not merely to gain tax incentives.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Adolph and Barbara E. Falso is granted to the extent that the real property tax credits for payments in lieu of taxes made pursuant to a written agreement with the Onondaga IDA, are granted, but in all other respects is denied;

2. The determination of the Administrative Law Judge is reversed to the extent indicated in paragraph "1" above, but is otherwise affirmed;

3. The petition of Adolph and Barbara E. Falso is granted to the extent indicated in paragraph "1" above, but is otherwise denied; and

4. The Notices of Deficiency, L-033002753 and L-033002752, dated January 14, 2010, as modified in accordance with paragraph "1" above, are sustained.

DATED: Albany, New York
May 23, 2013

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

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