STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
DAVID AND KAREN AYOUB **GREGG A. AND SHARON M. GOETTEL** **CARL I., Jr., AND BARBARA AUSTIN** **JAMES AND MAUREEN BOWERS** **DONALD R. AND SUSAN M. KIMBER** **DAVID AND KATHLEEN MISNER** **GARY AND JEAN PETRICK** **MICHAEL G. D'AVIRRO** **WILLIAM T. AND KELLEY L. KRIESEL**	: : : : : : : :	DETERMINATION DTA NOS. 823894, 823895, 823896, 823897, 823898, 823899, 823900, 823901, AND 824246
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, 2007 and 2008.	: :	

Petitioners David and Karen Ayoub, Gregg and Sharon Goettel, Carl and Barbara Austin, James and Maureen Bowers, and Donald R. and Susan M. Kimber filed petitions 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 David and Kathleen Misner filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the year 2007.

Petitioners Gary and Jean Petrick, Michael G. D'Avirro, and William and Kelley Kriesel filed petitions 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, 2007 and 2008.

A consolidated hearing was held before Timothy Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Agency Building 1, Empire State Plaza, Albany, New York, on March 19, 2012, at 10:30 A.M., with all evidence and briefs to be submitted by September 10, 2012, which date began the six-month period for the issuance of this determination. Petitioners appeared by Timothy M. Lynn, Esq. and Paul M. Predmore, Esq. The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel).

ISSUES

I. Whether a New York limited liability company through which petitioners claim QEZE tax reduction credits under Tax Law § 16 and refundable EZ wage tax credits under Tax Law § 606(k) was certified under Article 18-B of the General Municipal Law, as required to be eligible for such credits, pursuant to certification effective July 30, 2002.

II. If not, whether such limited liability company, having been certified under Article 18-B pursuant to certification effective August 12, 2004, had a base period, as defined in Tax Law § 14(c), of greater than zero years, thereby satisfied the employment test under Tax Law § 14(b)(1), and thus qualified for the QEZE tax reduction credits as claimed.

III. If not, whether petitioners have shown that the limited liability company was a new business as defined in Tax Law § 14(j)(2) and that petitioners are therefore entitled to the QEZE tax reduction credits as claimed.

IV. Whether petitioners have shown that the limited liability company was a new business as defined in Tax Law § 606(a)(10) and that petitioners are therefore entitled to refunds of empire zone wage tax credits as claimed pursuant to Tax Law § 606(k)(5).

FINDINGS OF FACT

Organizational History of Bowers & Company, CPAs, PLLC

1. For the tax years at issue, petitioners David Ayoub, Gregg Goettel, Carl Austin, James Bowers, Donald R. Kimber, David Misner, Gary Petrick, Michael G. D'Avirro, and William Kriesel were each members of an accounting practice operating under the name Bowers & Company, CPAs, PLLC (the MGD/Bowers PLLC).[1]

2. The MGD/Bowers PLLC is a New York limited liability company originally formed on July 15, 2002 as a single-member limited liability company under the name Michael G. D'Avirro, CPA, PLLC. Petitioner Michael G. D'Avirro was the sole member.

3. The single-member MGD/Bowers PLLC was created as part of a plan to combine the operations of two Syracuse area accounting firms, Pasquale & Bowers, LLP (P&B), a New York limited liability partnership, and Dermody, Burke & Brown, Certified Public Accountants, P.C. (Dermody P.C.), a New York professional services corporation. Mr. D'Avirro was a partner in P&B. The MGD/Bowers PLLC was the form of business organization to be used for the combined practice of P&B and Dermody P.C. It was created on July 15, 2002 to allow the entity for the combined practice to enter into a lease, dated August 22, 2002, for a commercial building undergoing substantial renovation at 443 North Franklin Street, Syracuse, New York.

4. The single-member MGD/Bowers PLLC also obtained certification for the combined practice under Article 18-B of the General Municipal Law as a Qualified Empire Zone Enterprise (QEZE). Specifically, pursuant to a Certificate of Eligibility dated October 2, 2002 and deemed

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[1] Petitioners Karen Ayoub, Sharon M. Goettel, Barbara Austin, Maureen Bowers, Susan M. Kimber, Kathleen Misner, Jean Petrick and Kelley L. Kriesel are parties solely because they filed joint returns with their spouses during the years at issue and were subsequently named in joint notices of deficiency under protest in this matter (***see*** Finding of Fact 54).

effective July 30, 2002, the MGD/Bowers PLLC, under the name Michael G. D'Avirro, CPA, PLLC, was so certified as a QEZE in connection with a facility located at 126 North Salina Street, Syracuse, New York.

5. 126 North Salina Street was the location of the offices of P&B under a lease that terminated on December 31, 2002.

6. On August 28, 2002, a Certificate of Amendment of the Articles of Organization of the MGD/Bowers PLLC was filed with the New York Secretary of State changing the name of that business entity from Michael G. D'Avirro, CPA, PLLC to Dermody, Burke & Brown, PLLC. This name change occurred in preparation for the admission of new members in connection with the planned joining of the accounting practices of P&B and Dermody P.C.

7. On December 24, 2002, a second Certificate of Amendment of the Articles of Organization of the MGD/Bowers PLLC was filed with the New York Secretary of State changing the name of the entity to Dermody, Burke & Brown, Certified Public Accountants, PLLC. This was a technical name change necessitated by New York State regulations that required the words "Certified Public Accountants" (or "CPAs") in the name of a public accounting firm.

8. For tax purposes, the single-member MGD/Bowers PLLC was a disregarded entity in 2002 and all activity of the PLLC during that year was reported on Mr. D'Avirro's 2002 personal income tax return. The specifics of such reported activity are not in the record.

9. As a single-member PLLC, the MGD/Bowers PLLC did not engage in the practice of accounting, had no employees, and engaged in no activities other than those noted above.

10. On January 1, 2003, the combined accounting practice began operations from offices located at 443 North Franklin Street, Syracuse, New York. On that date, 20 additional members were admitted as members of the MGD/Bowers PLLC, then operating under the name Dermody, Burke & Brown, Certified Public Accountants, PLLC. Fourteen of the new members had been shareholders of Dermody P.C. and six of the new members had been partners, along with Mr. D'Avirro, in P&B. The former P&B members that joined the MGD/Bowers PLLC on January 1, 2003 were petitioners Ayoub, Austin, Goettel, Bowers, Kimber, and Petrick.

11. Upon the admission of the 20 new members to the MGD/Bowers PLLC in January 2003, that business entity was no longer a single-member disregarded entity for tax purposes, but was now taxable as a partnership under a new federal employer identification number (EIN).

12. On January 24, 2003, the MGD/Bowers PLLC, under its then-current name, Dermody, Burke & Brown, Certified Public Accountants, PLLC, was certified as a QEZE under Article 18-B of the General Municipal Law, effective July 30, 2002. This certificate was issued to reflect the name change of the business entity, as the certificate number listed thereon is identical to that listed on the certificate of eligibility issued to the MGD/Bowers PLLC under the name Michael G. D'Avirro, CPA, PLLC (***see*** Finding of Fact 4).

13. The January 24, 2003 certification certified the MGD/Bowers PLLC in connection with a facility located at 126 North Salina Street; that is, P&B's former address. The MGD/Bowers PLLC, operating as the combined practice, did not maintain offices at that address at any point in time.

14. In 2004, irreconcilable differences arose among the members of the combined accounting practice. As a result, the members entered into a Separation Agreement, executed

and effective July 1, 2004, that addressed the withdrawal of certain members from the MGD/Bowers PLLC.

15. The separation occurred along the same lines as when members joined the combined group. That is, pursuant to the Separation Agreement, the members of the firm that had previously been shareholders of Dermody P.C. (Dermody members) had their membership interests in the MGD/Bowers PLLC redeemed. This left the MGD/Bowers PLLC with only the former P&B members as its owners.

16. As part of the separation plan, the Dermody members formed a new entity that acquired some of the assets and liabilities of the MGD/Bowers PLLC. This new company was formed on June 28, 2004. It was initially known as Killory & Sarenski, CPAs, LLC, and then, after an amendment to its original Articles of Organization, as Dermody, Burke & Brown, CPAs, LLC (K&S/DBB).

17. The Separation Agreement provided that the redemptions of the membership interests of the Dermody members were, for tax purposes, intended to be treated as an assets-over form division of a partnership where at least one resulting partnership is a continuation of the prior partnership in accordance with Treas Reg §1.708-1(d)(3)(i)(A), and that accordingly, pursuant to the same regulation, the federal employer identification number used by the combined practice, operating through the MGD/Bowers PLLC, would become the EIN of K&S/DBB. At the same time, the MGD/Bowers PLLC applied for and received a new EIN.

18. At the time of the separation the Dermody members had an interest of more than 50 percent in the capital and profits of the combined accounting practice operating as the MGD/Bowers PLLC.

19. On July 19, 2004, following the redemption of the membership interests of the Dermody members, the remaining members of the MGD/Bowers PLLC, i.e., the P&B members, filed a third Certificate of Amendment of the Articles of Organization with the New York Secretary of State changing the name of the business entity to its present name, Bowers & Company, CPAs, PLLC (Bowers).

20. Bowers filed partnership tax returns under its new employer identification number commencing with the tax year July 1, 2004 through December 31, 2004 and continuing through each of the tax years at issue.

21. The separation did not result in any gain recognition with respect to Bowers's receivables or other assets. Additionally, Bowers continued its existing depreciation schedule with respect to all of its assets. Also, the payroll tax obligations of the business entity were unaffected even though the new employer identification number was issued in the middle of a tax year.

22. Soon after the separation, in or about August 2004, the P&B members, now operating as Bowers, relocated to MONY Tower, Syracuse, New York.

23. On October 28, 2004, a Certificate of Eligibility as an empire zone enterprise under Article 18-B of the General Municipal Law was issued to Bowers, effective August 12, 2004, in connection with facilities located at MONY Tower, Syracuse, New York. This certificate bears a different certificate number from the certificates previously issued to the MGD/Bowers PLLC (***see*** Findings of Fact 4 and 12).

24. The Bowers application for certification as a QEZE, dated August 5, 2004, reported that it was an existing business and as an explanation of the basis for its claims to hire new employees or make capital investments, the application states:

> The company is an existing accounting firm which has changed ownership. The change in ownership has resulted in the company being treated as a new partnership for federal and state tax purposes, and a new federal identification number has been assigned. The company currently has 11 new employees and will hire at least 4 additional full-time employees in the next 12-18 months. It is being relocated to a new location and will commence hiring new employees immediately. Further, the company plans to invest $150,000 in furniture, computer equipment and office renovations over the next two years.

Differences Among Accounting Practices

25. Typically, the management of an accounting firm determines how the firm will operate. The type of clients that it serves is another factor in determining how an accounting firm will operate.

26. Accounting practices, even of the same size and in the same geographic area, may differ from one another in a number of ways. Among such differences are the type of clients that are served, the type of services that are offered, and the approach to operation. For example, some accounting firms cater primarily to business clients (public or private, large or small), some specialize in individual matters, others work extensively with not-for-profit organizations, governmental agencies, or other specialty niche clients. Some accounting firms limit their services to tax and audit work, others offer financial planning, investment advice, fraud examination, and valuation services. There are also differences in how audit work is performed. Some accounting firms use the substantive approach and others use the risk-based approach to audits. Some firms use specific types of software or programs (e.g., QuickBooks) when working with their clients.

The Pasquale & Bowers Firm

27. As noted previously, before the combining of the P&B and Dermody P.C. accounting practices on January 1, 2003, seven of the petitioners that are now members of Bowers (that is, petitioners Ayoub, Goettel, Austin, Bowers, Kimber, Petrick, and D'Avirro) were partners in the

P&B accounting firm. P&B was founded in 1977 by Al Pasquale. Mr. Pasquale was the sole managing partner of P&B from 1977 until 1999. He established the culture and oversaw all aspects of the operations of P&B.

28. During the time Mr. Pasquale managed P&B, about 90 percent of the revenues of the firm came from audit and tax return services for medium to large privately held businesses and their high net worth owners. Most of these clients had relationships directly with Mr. Pasquale.

29. During the time Mr. Pasquale managed P&B, the firm seldom did any individual tax return work unless the individual was related to one of the firm's business clients. Individual tax return preparation work for people that were not affiliated with business clients of P&B was generally referred to other accounting practices in the area.

30. During the time Mr. Pasquale managed P&B, the firm did little, if any, work for not-for-profit clients or governmental agencies.

31. P&B used the substantive approach in the audit work that it performed for clients. Under this audit method, the accountant works primarily with the client's financial statements and verifies year-end balances on those statements. This was the audit approach preferred by Mr. Pasquale.

32. During the time that Mr. Pasquale managed P&B, that firm never acquired another accounting practice or otherwise took any steps to diversify either the services provided to its limited range of clients or its client base.

Transition Away from the P&B Operations

33. Mr. Pasquale gave up management of P&B at the end of 1999 and petitioners Michael G. D'Avirro and Carl Austin took over the management responsibilities of P&B. For the years

2000 and 2001, D'Avirro and Austin continued to operate P&B much as Mr. Pasquale had managed the firm.

34. After taking over the management of P&B, D'Avirro and Austin recognized that its operation would need to change for the firm to remain competitive. They felt they needed to diversify the services of the firm beyond audit and tax work for a narrow range of medium to large businesses and high net worth individuals. The decision was made to accomplish this diversification either by acquiring or combining with one or more other accounting practices in the area that offered a broader range of services than P&B.

35. By 2002, P&B was engaged in discussions with several firms in central New York about possible acquisition or merger. Ultimately, it was determined that the Dermody P.C. accounting firm was the best candidate to pursue to accomplish the goal of diversifying the services of P&B. Dermody P.C. appealed to Mr. D'Avirro because it was a diversified practice that operated differently from the P&B model established by Mr. Pasquale. Specifically, Dermody P.C. had a strong not-for-profit client base, they worked with small banks, they had a large number of individual tax returns, and they offered bookkeeping and financial planning services.

Operations of the Combined Practice

36. As discussed, the practices of Dermody P.C. and P&G did combine, effective January 1, 2003. The combined practice operated differently than the former operation of P&B. The combined practice was a diversified accounting firm that attracted many of the business clients of P&B, but also served not-for-profit organizations and many individual clients that were unrelated to any businesses. The new firm also had certified financial planners.

Post-Separation Operations of Bowers

37. At the time of the separation, clients of the combined practice that had been related to the P&B members continued as clients of Bowers. Similarly, clients of the combined practice that had been related to the Dermody members continued as clients of K&S/DBB.

38. As noted, soon after the separation, the Bowers accounting practice rented office space at a new location at MONY Tower in Syracuse, New York. Bowers continued to operate differently from P&B and continued to seek to diversify its services in a manner similar to those offered in the combined practice. Bowers provided services for individuals that were not related to medium to large businesses. The firm trained personnel in Quickbooks and became Quickbooks Pro Advisors. The firm also hired certified financial planners and offered financial planning services.

39. Additionally, the post-separation operation of Bowers included the acquisition of other accounting firms to bolster the firm's client base in the areas of individual returns, not-for-profit work, governmental work and financial planning and investment advice.

40. The post-separation operation of Bowers continued to provide audit services, but now used the risk-based approach to audit work, an approach learned while practicing with the Dermody members, as opposed to the substantive approach that had been used at P&B.

41. Post-separation Bowers had equity and non-equity owners of the business. P&B never had non-equity partners.

42. Among the changes from how P&B operated, post-separation Bowers allowed employees to work part-time, have flexible time arrangements, and to work from home. The decision to allow Bowers employees to work at home was attributable to a substantial investment in technology resources.

43. Post-separation Bowers also established an association with CPA USA, a national affiliation of accounting firms that provided support services with respect to foreign jurisdictions and other resources with respect to operational issues. Dermody P.C. had been a member of such national associations before the practices joined together, but P&B had never been affiliated with such associations.

44. Post-separation Bowers had about 20 to 25 percent of its business attributable to medium and large privately owned businesses and their owners. In contrast, P&B had about 90 percent of its business attributable to such clients.

45. As a result of these changes in operation between P&B and Bowers, Bowers has grown from 11 employees in July 2004 immediately post-separation to 35 employees in March 2012. This growth is attributable to the diversification of the services offered by Bowers in comparison to the services offered by P&B.

Tax Returns, Audit and Issuance of Notices of Deficiency

46. As relevant herein, petitioners timely filed their 2006, 2007, and 2008 New York State personal income tax returns. On those returns, petitioners claimed QEZE tax reduction credits and refundable empire zone wage tax credits in connection with their membership interests in Bowers.

47. Bowers's New York partnership returns (Form IT-204) for each of the years 2006 through 2008 claim QEZE tax reduction credits and empire zone wage tax credits. All of these claims for credit report August 12, 2004 as the "Date of first certification by Empire State Development" (Claim for QEZE Tax Reduction Credit [Form IT-604]) and "Date of EZ designation" (Claim for EZ Wage Tax Credit [Form IT-601]). Additionally, all of these returns report July 1, 2004 as the "date business started."

48. In connection with the claims for credit, the Bowers partnership returns report an "employment number" in the empire zone (for QEZE tax reduction credit [Form IT-604]) as well as an "average number of full-time employees" in the empire zone (for EZ wage credit [Form IT-601]) of 10, 16 and 14, respectively, for the years 2006, 2007 and 2008.

49. Bowers's 2006-2008 claims for QEZE tax reduction credit report zero base period employment and zero employment during a January-December 2003 test year.

50. Bowers's 2006-2008 claims for EZ wage tax credit report zero employees during a four-year test period consisting of the four years immediately preceding the first tax year for which such credit was claimed. Such claims further report that the EZ wage tax credit claims for 2006, 2007 and 2008 are, respectively, the third, fourth and fifth tax years in which such credit was claimed. Based on such reporting, the first tax year in which Bowers and its members claimed EZ wage credit was the July 1 - December 31, 2004 tax year.

51. Petitioners' claims for QEZE tax reduction credits and EZ wage tax credits as reflected on the IT-604 and IT-601 forms attached to their individual returns are consistent with the information reported on the Bowers partnership returns as noted above.

52. With the exception of petitioner Misner, all petitioners herein claimed either nonrefundable EZ wage tax credits or EZ wage tax credits available as a carryforward, or both, for each of the tax years in dispute. Such claims were not challenged by the Division on audit.

53. The Division conducted an audit of petitioners' returns for the years at issue and determined that petitioners were not entitled to QEZE tax reduction credits and the refundable portion of the EZ wage credits as claimed on the returns because, as indicated on various statements of audit changes issued to petitioners, Bowers was first certified as a QEZE between August 1, 2002 and March 31, 2005, had a base period of zero years and did not qualify as a

"new business" under Tax Law § 14(j) because it was substantially similar in ownership and operation to another business enterprise taxable or previously taxable under any of various articles of the Tax Law, including articles 9-A and 22.

54. The Division issued notices of deficiency to petitioners asserting additional tax due, plus interest, resulting from the denial of the claimed QEZE tax reduction credits and refundable portion of the EZ wage tax credits. The particulars of the notices, as well as a breakdown of the QEZE tax reduction and refundable EZ wage credit components of the deficiencies, are set forth below:

Petitioner	Notice No.	Notice Date	Year	QEZE Tax Red.	EZ Wage	Tax Due[2]
Ayoub	L032781220	01/11/10	2006	$10,880.00	$1,062.00	$11,942.00
Ayoub	L032781222	01/11/10	2007	$11,829.00	$1,528.00	$13,357.00
Goettel	L032742021	02/22/10	2006	$10,438.00	0.00	$10,438.42
Goettel	L032742020	02/22/10	2007	$11,355.00	0.00	$11,355.42
Austin	L032659458	02/22/10	2006	$14,574.00	$1,063.00	$15,637.27
Austin	L032659459	02/22/10	2007	$12,806.00	$1,528.00	$14,334.49
Bowers	L032620599	02/22/10	2006	$15,990.00	0.00	$15,990.00
Bowers	L032620598	02/22/10	2007	$15,045.00	0.00	$15,045.11
Kimber	L032781224	02/22/10	2006	$10,481.00	$1,063.00	$11,544.00
Kimber	L032781221	02/22/10	2007	$10,799.00	$1,528.00	$12,327.00
Misner	L032574637	10/05/09	2007	$ 6,895.00	0.00	$ 6,895.00
Petrick	L032684863	02/22/10	2006	$ 9,769.00	0.00	$ 9,769.30
Petrick	L032684864	02/22/10	2007	$ 9,455.00	0.00	$ 9,455.16
Petrick	L032853899	02/22/10	2008	$10,967.00	0.00	$10,967.34

[2] Tax due amounts listed are from the notices of deficiency. QEZE tax reduction and EZ wage credits are from petitioners' income tax returns. The minor differences, for some of the assessments, between the claimed credit totals and tax due probably result from rounding. In any event, the accuracy of the Division's calculations is not in dispute.

D'Avirro	L032830001	02/22/10	2006	$17,453.00	$1,063.00	$18,516.00
D'Avirro	L032830000	02/22/10	2007	$15,023.00	$1,528.00	$16,551.00
D'Avirro	L032728125	03/15/10	2008	$16,504.00	$1,445.00	$17,949.14
Kriesel	L032781219	02/22/10	2006	$11,751.00	$1,063.00	$12,814.36
Kriesel	L032853898	12/28/09	2007	0.00	$1,528.00	$ 1,528.11
Kriesel	L032781223	02/22/10	2007	$13,886.00	0.00	$13,886.00
Kriesel	L032728124	02/22/10	2008	$15,021.00	$1,445.00	$16,466.16

55. Pursuant to conciliation orders dated September 17, 2010, the notices of deficiency issued to the Ayoub, Goettel, Austin, Bowers, Kimber, Misner, Petrick, and D'Avirro petitioners were sustained.

56. With respect to the Kriesel petitioners, by conciliation orders dated January 21, 2011, notice number L032781219 was recomputed to $1,685.00 plus interest, notice number L032853898 was sustained, notice number L032781223 was recomputed to $12,177.89 plus interest, and notice number L032728124 was recomputed to $9,576.00 plus interest. It appears that those deficiencies were adjusted because the Kriesel returns also claimed QEZE tax reduction and EZ wage credits in connection with one or more business enterprises certified under Article 18-B of the General Municipal Law other than Bowers and unrelated to the present matter. The amount remaining due results from a denial of such credits as related to Bowers only.

57. The Division's auditor was aware that, as a result of the separation, the MGD/Bowers PLLC, operating as Bowers, was required to obtain a new federal employer identification number, but was aware of no other impact of the separation on Bowers from a tax perspective.

Proposed Findings of Fact

58. Petitioners submitted proposed findings of fact numbered 1-48. Proposed findings of fact 1-11, 13-25, 27-29, 31-33, 35, 37, 39-41, 43, 44, and 47 are accepted and have been incorporated, in substance, in these findings of fact. Proposed findings of fact 12, 26, 30, 34, 36, 38, 42, 45, 46 and 48 have been modified to better reflect the record, and, as modified, have been incorporated into these findings of fact.

SUMMARY OF THE PARTIES' POSITIONS

59. Petitioners contend that the July 30, 2002 certification of the MGD/Bowers PLLC under Article 18-B of the General Municipal Law remains in effect and is applicable to the post-separation operation of the MGD/Bowers PLLC, now operating as Bowers. Consequently, petitioners assert that, as a business enterprise first certified prior to August 1, 2002, the MGD/Bowers PLLC was not subject to the "new business test" under Tax Law § 14(j)(2), notwithstanding that it had a base period of zero years, and therefore qualifies as a QEZE under that same section. As a result, petitioners assert, they are entitled to the tax credits as claimed herein.

60. Alternatively, if the August 12, 2004 certification under Article 18-B is applicable, petitioners contend that the MGD/Bowers PLLC had a base period of greater than zero years and, as a consequence, was not subject to the "new business test" under Tax Law § 14(j)(2) and thereby satisfied the employment test under Tax Law § 14(b)(1). Specifically, petitioners assert that the taxable years of the MGD/Bowers PLLC during the year it was a single-member entity and during 18 months it was a 21-member PLLC constitute taxable years for the post-separation MGD/Bowers PLLC.

61. Petitioners contend that, even if they do not prevail on their first two arguments, they are nonetheless entitled to the claimed credits because Bowers passes the new business test; that is, Bowers is not substantially similar in ownership and operation to another business enterprise taxable or previously taxable under, among others, articles 9-A or 22 of the Tax Law.

62. The Division contends that the July 30, 2002 Article 18-B certification is not applicable in determining entitlement to the credits at issue because, following the separation, the MGD/Bowers PLLC, now operating as Bowers, is considered a new partnership for federal and New York income tax purposes pursuant to Internal Revenue Code (IRC) § 708. Accordingly, the Division argues, Bowers is not the same business entity as the single-member PLLC for the purpose of claiming Enterprise Zone credits. The Division thus asserts that the August 12, 2004 certification is applicable.

63. The Division further contends that, because it is considered a new partnership under IRC § 708, Bowers has a base period of zero years and may not include any of the tax years of the combined practice or the single-member PLLC in its base period. Accordingly, the Division asserts that Bowers is subject to the new business test.

64. With respect to the new business test, the Division asserts that Bowers is substantially similar in ownership and operation to P&B and therefore fails the test.

CONCLUSIONS OF LAW

A. Petitioners claim QEZE tax reduction credits pursuant to Tax Law §§ 16 and 606(cc) and refunds of empire zone (EZ) wage tax credits under Tax Law § 606(k). "A tax credit is 'a particularized species of exemption from taxation'(***Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193, 197, 371 NYS2d 715 [1975], ***lv denied*** 37 NY2d 708 [1975]) and, therefore, petitioner[s] bore the burden of showing 'a clear cut entitlement' to the statutory

benefit[s] (***Matter of Luther Forest Corp. v. McGuiness***, 164 AD2d 629, 632, 565 NYS2d 570 [3d Dept 1991])" (***Matter of Golub Service Station v. Tax Appeals Tribunal***, 181 AD2d 216, 585 NYS2d 864 [3d Dept 1992]). Indeed, petitioners must show that their interpretation of the law is "not only plausible, but the only reasonable construction" (***Matter of Brookfield Power New York Corp.***, Tax Appeals Tribunal, November 10, 2010). Nevertheless, construction of an exemption statute should not be so narrow as to defeat the exemption's settled purpose (***Matter of Grace v. New York State Tax Commn.***, 37 NY2d at 196, 371 NYS2d at 718).

B. As relevant herein, Tax Law § 606(cc) allows a QEZE tax reduction credit against the tax imposed under Article 22 for a taxpayer who is "a member of a partnership which is a QEZE." Similarly, Tax Law § 16(a) provides for a QEZE tax reduction credit by which a member of a partnership that is a QEZE, and who is subject to personal income tax under Article 22 of the Tax Law, shall be allowed a credit against such personal income tax.

C. A QEZE is a "business enterprise" that is certified under Article 18-B of the General Municipal Law and that meets the employment test in Tax Law § 14(b) (Tax Law § 14[a]).

D. Generally, the employment test under Tax Law § 14(b) requires that the business enterprise show that the average number of full-time employees ("employment number" [Tax Law § 14(g)]) during the tax year equals or exceeds the average number of such employees during the "base period." The "base period" means the five taxable years immediately preceding the "test year" or if the business enterprise has fewer than five such years, then that smaller set of years (Tax Law § 14[c]). The "test year" is the last taxable year of the business enterprise ending before the "test date," or if the enterprise does not have such a taxable year, then it shall be deemed to have a test year consisting of either the last calendar year or the last fiscal year ending on or before the test date (Tax Law § 14[d]). The "test date" is, generally, the date the business

enterprise was first certified under Article 18-B of the General Municipal Law (Tax Law § 14[e]).

E. For a business enterprise first certified on or after August 1, 2002 and before April 1, 2005, if the base period is zero years and the employment number in the empire zone is greater than zero in the current tax year, then the enterprise passes the employment test only if it qualifies as a "new business" (Tax Law § 14[b][1]). A new business is one that is not substantially similar in operation and in ownership to a business entity taxable or previously taxable under various articles of the Tax Law, including articles 9-A and 22 (Tax Law § 14[j][2]). A business enterprise first certified before August 1, 2002, with a base period of zero years and an employment number in the empire zone of greater than zero in the current year is not required to meet the above-noted definition of new business in order to pass the employment test (***see*** Tax Law § 14[j][4][B]; ***see also*** Instructions for Form IT-604 [IT-604-I]).[3]

F. As noted, petitioners contend that the July 30, 2002 certification of the MGD/Bowers PLLC is applicable to the post-separation MGD/Bowers PLLC, now operating as Bowers. Petitioners maintain this position notwithstanding that all QEZE tax reduction credits and EZ wage tax credits claimed herein use the August 12, 2004 certification date as their starting point and all report no employment history for the MGD/Bowers PLLC prior to that date (***see*** Findings of Fact 47-51). Petitioners want the July 30, 2002 certification date in order to avoid the new

[3] For tax years commencing on or after January 1, 2005, a business enterprise certified before August 1, 2002, with a base period of zero years or zero employment in the base period, that is similar in operation and in ownership to an existing or previously existing taxpayer must meet a valid business purpose test in order to qualify for the QEZE tax reduction credit (Tax Law § 14[j][4][B]). This is the so-called shirt-changer provision (***see Matter of Dunk & Bright Furniture Co.***, Tax Appeals Tribunal, June 28, 2012). The Division did not deny petitioners' credit claims on this basis, however, and at no point in this proceeding did the Division assert that the MGD/Bowers PLLC, in any of its incarnations, was a shirt-changer. Accordingly, and also considering Conclusion of Law L, this determination does not address the valid business purpose test.

business test component of the employment test applicable to QEZEs certified on or after August 1, 2001 (***see*** Tax Law § 14[b][1]).[4]

G. For federal income tax reporting purposes, any noncorporate business entity with two or more members, such as a limited liability company or PLLC, may be classified as either a partnership or an association (and thus a corporation) (Treas Reg § 301.7701-3[a]).[5] Accordingly, while LLCs and PLLCs are entities created by statute (***see*** Limited Liability Company Law §§ 201 and 1203), they are not recognized as such for tax reporting purposes.

H. For purposes of Article 22, "partnership" includes a limited liability company that is classified as a partnership for federal income tax purposes (Tax Law § 601[f]).[6]

I. In the present matter, both the combined accounting practice, operating as the MGD/Bowers PLLC and under the name Dermody, Burke & Brown, Certified Public Accountants, PLLC, and the post-separation practice of the P&B members, also operating as the MGD/Bowers PLLC, but under the Bowers name, were classified as partnerships for federal and New York income tax reporting purposes.

J. Internal Revenue Code (IRC) § 708(b)(2)(B) provides as follows:

> In the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) shall, for purposes of this section, be considered a continuation of the prior partnership.

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[4] This question of whether the new business test applies or not depending upon the applicable date of certification is relevant only with respect to petitioners' QEZE tax reduction credit claims. Petitioners' EZ wage tax credit refunds are subject to a new business test irrespective of the date of certification (***see*** Conclusion of Law U).

[5] A single-member limited liability company may report as a disregarded entity (***see*** Treas Reg § 301.7701-1[a][4]).

[6] The term "limited liability companies" as used in Tax Law § 601(f) includes professional service limited liability companies, as such entities are a form of LLC and there are no relevant distinctions, for tax reporting purposes, between limited liability companies formed under Limited Liability Company Law § 201 and professional service limited liability companies formed under Limited Liability Company Law § 1203.

Additionally, IRC regulations provide that any resulting partnership, the members of which had an interest of less than 50 percent, "will not be considered a continuation of the prior partnership but will be considered a new partnership" (Treas Reg § 1.708-1[d][1]).

K. In the present matter the Dermody members had an interest of more than 50 percent in the capital and profits of the combined accounting practice partnership operating as the MGD/Bowers PLLC (***see*** Finding of Fact 18). Accordingly, effective July 1, 2004, upon division of that partnership pursuant to the Separation Agreement, the P&B members became members of a new partnership by operation of IRC § 708(b)(2)(B) and Treas Reg § 1.708-1(d)(1), notwithstanding that such members continued to operate as the MGD/Bowers PLLC. At the same time, the Dermody members' partnership, although operating as the newly-formed K&S/DBB LLC, was deemed a continuation of the prior partnership that had been composed of members of the combined practice operating as the MGD/Bowers PLLC. Consistent with this outcome, the MGD/Bowers PLLC, now operating as Bowers, obtained a new federal employer identification number, while K&S/DBB kept the employer identification number that had previously been used by the combined practice partnership, operating as the MGD/Bowers PLLC (***see*** Finding of Fact 17). Additionally, as also required under the regulations (Treas Reg § 1.708-1[d][2][i]), the new partnership, operating as Bowers, filed a separate tax return, with its new EIN, for the short taxable year beginning on the effective date of the division (***see*** Finding of Fact 20).

L. For the years at issue, then, petitioners were members of a partnership that came into existence on July 1, 2004. This new partnership was granted QEZE certification effective August 12, 2004 (***see*** Finding of Fact 23). Logically, petitioners must use the Empire Zone

attributes of that new partnership, including its QEZE certification date, in claiming QEZE tax reduction credits, as their entitlement to such credits rests upon their status as members of that new partnership (***see*** Tax Law §§ 16 and 606[cc]). As noted previously, for all of the years at issue, every petitioner in the present matter claimed QEZE tax reduction credits, as well as Empire Zone wage tax credits, using the Empire Zone attributes of the new partnership, including the August 12, 2004 certification date.

M. Conversely, there is no authority in the Tax Law for taxpayers to claim QEZE tax reduction credits using the date of certification of a partnership of which they are no longer members. Thus petitioners may not claim QEZE tax reduction credits using the July 30, 2002 certification that had been used by members of the combined practice partnership, as petitioners were no longer members of that continuing partnership as of July 1, 2004.

N. Petitioners contend that all Empire Zone attributes should follow the MGD/Bowers PLLC, and that therefore the new post-separation partnership of the P&B members, operating as the MGD/Bowers PLLC, should be entitled to use the July 30, 2002 certification as the basis of their credit claims. Petitioners' contention rests on the continuity of existence of the MGD/Bowers PLLC (***see*** Findings of Fact 2, 6, 7, and 19) and their contention that the term "business enterprise" as used in Tax Law § 14(a) means "business entity." They argue, accordingly, that, since the MGD/Bowers PLLC business entity continues to exist, it should retain the QEZE attributes devolving from the July 30, 2002 certification.

O. Petitioners' contention is rejected. As noted, Tax § 14(a) defines a QEZE in terms of a "business enterprise" that is certified under Article 18-B of the General Municipal Law. While "business enterprise" is not defined in the Tax Law, its meaning in determining entitlement to the QEZE tax reduction credit may be ascertained by reference to Tax Law § 16(a), which allows

such credit to certain business entities based on their tax reporting classifications. Specifically, that section allows such credit to a corporation ("a taxpayer which is a [QEZE]"), a disregarded entity (a taxpayer "which is the sole proprietor of a QEZE"), or a partnership ("a member of a partnership which is a QEZE"). Tax Law § 16(a) does not provide for QEZE tax reduction credits for an enterprise organized as a limited liability company, because such an entity is not recognized as such for tax reporting purposes (***see*** Conclusion of Law G). Accordingly, Empire Zone attributes do not follow an LLC entity, but are obtainable through the reporting classification chosen by the LLC. The Internal Revenue Code and regulations regarding the chosen reporting classification may impact the Empire Zone attributes associated with the LLC.

In the present matter, both the combined accounting practice and the post-separation practice of the P&B members chose to be classified as partnerships. In accordance with Tax Law § 16(a), as well as Tax Law § 606(cc), it is their status as partnerships that is dispositive in determining their members' entitlement to the QEZE tax reduction credits. As noted above, one tax consequence of this choice of partnership status was that, upon separation of the combined practice, the P&B members became members of a new partnership. Additionally, the partnership of which the P&B members had formerly been a part now consisted of the Dermody members and it continued to exist. The new partnership, i.e., the post-separation practice of the P&B members, was therefore a separate and distinct business enterprise under Tax Law §14 and necessarily required (and, in fact, obtained) its own certification under Article 18-B of the General Municipal Law (***see*** Finding of Fact 23). Accordingly, the Empire Zone attributes of the combined practice partnership did not follow the P&B members to the new partnership and the August 12, 2004, certification date for the new partnership is applicable to the post-separation partnership of the P&B members. That the new partnership was organized as the MGD/Bowers

PLLC is irrelevant, given the nonrecognition of limited liability companies for tax reporting purposes.

P. Petitioners cite an advisory opinion (TSB-A-09[14]I) in support of their contention that "business enterprise" for Tax Law § 14(a) purposes means "business entity" and that the continued existence of the MGD/Bowers PLLC business entity compels a result in their favor. The advisory opinion determined that QEZE tax benefits would not be affected where a single-member limited liability company (SMLCC) certified under Article 18-B of the General Municipal Law and treated as a disregarded entity (DE) for tax reporting purposes made an election to be taxed as a subchapter S corporation. The advisory opinion reasoned:

> Although "business enterprise" is not defined in the Tax Law, it can be said that the "business entity" is Petitioner, the SMLCC. Thus, when Petitioner elects to be treated as an S corporation, it may claim the credits for the benefit period remaining to Petitioner when it was treated as a DE.

Petitioners argue that a conversion from a disregarded entity to an S corporation as in the advisory opinion was of greater tax substance than the "technical termination" under IRC § 708 as occurred herein.

Q. With respect to the relevance of the cited advisory opinion, it is noted that such opinions are not precedential and are in no way binding herein (***see*** Tax Law § 171[24]; 20 NYCRR 2376.4). Nevertheless, even considering its merits, the opinion is distinguishable from the present matter and thus lends little support to petitioners' position. Specifically, the advisory opinion involves a single-member entity's elected change of reporting classification, while the instant matter involves the division of one reporting entity into two reporting entities. The former may be viewed as a technical change and it would seem reasonable that the QEZE

attributes would be unaffected.[7] The latter involves, contrary to petitioners' contention, many real and substantive changes as a single business was divided in two (***see*** Findings of Fact 22 and 37), and for tax purposes, as discussed, resulted in one continuing partnership and one new partnership. These changes, which are clearly more than "solely" a change of the employer identification number, as petitioners assert, justify the difference in outcome between the cited advisory opinion and the instant matter.

R. Alternatively, petitioners contend that even if the August 12, 2004 certification date is applicable, the MGD/Bowers PLLC had a base period of greater than zero years and therefore is not subject to the new business test pursuant to Tax Law § 14(b)(1) (***see*** Conclusion of Law E).

As with the question of the applicability of the July 30, 2002 certification, petitioners' position is premised on the continued existence of the MGD/Bowers PLLC from July 15, 2002 through the years at issue. Specifically, petitioners contend that the base period of the new partnership of the P&B members, operating as the MGD/Bowers PLLC, consisted of the July 15-December 31, 2002 tax year, where the single-member MGD/Bowers PLLC reported as a disregarded entity on Mr. D'Avirro's return and the 2003 tax year, where the combined practice MGD/Bowers PLLC reported as a partnership. Petitioners also contend that the combined practice partnership's short tax year of January 1-June 30, 2004 was the new partnership's "test year" (***see*** Tax Law § 14[d]).

S. Petitioners' contention is rejected. As discussed previously, upon the July 1, 2004, separation, the resulting partnership of the P&B members was deemed a new partnership and the

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[7] The situation in the advisory opinion is similar to the change in reporting classification in the present matter when the single-member, disregarded entity MGD/Bowers PLLC became a partnership effective January 1, 2003 (***see*** Finding of Fact 11). Here, as in the advisory opinion, a single business entity changed reporting classification and Empire Zone attributes were unaffected. As with the fact pattern of the advisory opinion, petitioners claim, wrongly, that this change was more substantive than the division of the partnership.

resulting partnership of Dermody members was deemed a continuation of the prior partnership (***see*** Conclusion of Law K). As with the question of the QEZE certification date, petitioners must use the Empire Zone attributes of the partnership of which they are members and may not use the Empire Zone attributes of a partnership that continued to exist, but of which they are no longer members (***see*** Conclusions of Law L, M, and O). Accordingly, petitioners may not include the 2002 and 2003 tax years in the base period of Bowers. Bowers therefore had a base period of zero years and was subject to the new business test pursuant to Tax Law Tax Law § 14(b)(1).

T. It is observed that, even if petitioners prevailed on Issue II and avoided the new business test under Tax Law § 14(j)(2), they would nonetheless fail the employment test of Tax Law § 14(b) because they have not shown that Bowers's employment number during any of the years at issue equaled or exceeded the employment number during the proposed base period (***see*** Conclusion of Law D). Contrary to petitioners' position, avoidance of the new business test by reporting a base period of greater than zero years does not mean that the employment test has been met. It only means that the additional hurdle of the new business test has been avoided. The business enterprise still must show that its employment number during a given tax year equaled or exceeded its employment number during the base period. Petitioners have made no such showing in this matter. If, as petitioners contend, the new partnership, i.e., Bowers, may use the continuing partnership's reporting history as its base period, it must also use the continuing partnership's employment history in calculating its employment number during the base period. It may not cherry-pick favorable Empire Zone attributes and disregard unfavorable ones. As there is no evidence in the record of the employment number of the combined practice from

January 1, 2003 through June 30, 2004, petitioners would fail the employment test and thus fail to qualify for the QEZE tax reduction credit on this alternative basis as well.[8]

U. Finally, having concluded that Bowers was certified on August 12, 2004, has a base period of zero years and is therefore subject to the new business test under Tax Law § 14(j)(2), it must be determined if Bowers passes the test.

As noted previously, an individual who is a member of a partnership shall qualify as an owner of a new business unless the business of which the individual is an owner is substantially similar in operation and in ownership to a business entity taxable or previously taxable under various articles of the Tax Law, including articles 9-A and 22, or the income or losses of which is or was includable under article 22 (Tax Law § 14[j][2]).

The refunds of EZ wage tax credit at issue are also subject to a similar new business test. Specifically, such refunds are available to a taxpayer who qualifies as "an owner of a new business for purposes of [Tax Law § 606(a)(10)]." As relevant herein Tax Law § 606(a)(10) provides that "a member of a partnership shall qualify as an owner of a new business unless: (A) the business . . . is substantially similar in operation and in ownership to a business entity . . . the income (or losses) of which is (or was) includable under article 22." In contrast to the QEZE tax reduction credit, the new business test for a refund of EZ wage tax credit is not tied to the date of certification under Article 18-B of the General Municipal Law (***see*** Conclusion of Law E).

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[8] Considering that the combined partnership had 21 members throughout its run and that the 7-member new partnership had 11 employees as of the date of its formation, it seems likely that the combined partnership had an employee number well in excess of 11. The partnership returns for the years at issue report employment numbers of 10, 16 and 14, respectively (***see*** Finding of Fact 47). Whether Bowers' employment numbers during the years at issue would have equaled or exceeded the actual employment number from the proposed base period thus appears questionable.

Here, petitioners contend that Bowers is not substantially similar in operation to P&B.[9] The Division contends that it is.

V. Petitioners have failed to meet their burden to show that, during the years at issue, Bowers was not substantially similar in operation to P&B. At the time of the separation from the Dermody members on July 1, 2004, Bowers's client base was the same as P&B's client base (***see*** Finding of Fact 37) and the members of Bowers were the same as the members of P&B (***see*** Finding of Fact 27). That the same accountants were providing accounting services to the same clients does not support a finding that, at least at the outset, Bowers was substantially different in operation from P&B, notwithstanding that there may have been some differences in the manner of providing such services. While the record shows that Bowers made numerous changes to its operation since it began doing business on July 1, 2004 (***see*** Findings of Fact 38-45), the dates of implementation of those changes are not in the record and there is no evidence to show that any of these changes were implemented prior to or during the years at issue. Moreover, Bowers's March 2012 employment level of 35 (***see*** Finding of Fact 45) as compared with employment during the years at issue (***see*** Finding of Fact 48) and its employment level at the time of separation (***see*** Finding of Fact 45) suggest that the most significant changes denoted herein were made after the years at issue. Accordingly, petitioners have failed to establish that Bowers was not substantially similar in operation to P&B during the years at issue. The subject claims for QEZE tax reduction credit and refunds of EZ wage tax credit are therefore properly denied.

W. In their brief, petitioners cite administrative law judge determinations in support of their position. In response, the Division cite the same determinations arguing that they do not

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[9] Apparently given the significant overlap in ownership between Bowers and P&B, petitioners do not contest the similarity in ownership prong of the test.

support petitioners' position. Tax Law § 2010(5) provides that administrative law judge determinations "shall not be cited, shall not be considered as precedent nor be given any force or effect in any other proceedings conducted pursuant to the authority of the [Division of Tax Appeals]." Accordingly, the determinations cited in the briefs are not cited herein and have not been given any force or effect in this determination.

X. The petitions of David and Karen Ayoub, Gregg and Sharon Goettel, Carl and Barbara Austin, James and Maureen Bowers, Donald R. and Susan M. Kimber, David and Kathleen Misner, Gary and Jean Petrick, Michael G. D'Avirro, and William and Kelley Kriesel are denied, and the notices of deficiency listed in Finding of Fact 54, modified as indicated in Finding of Fact 56, are sustained.

DATED: Albany, New York
February 21, 2013

/s/ Timothy Alston
ADMINISTRATIVE LAW JUDGE