

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

---

In the Matter of the Petitions	:
of	:
<b>DAVID AND KAREN AYOUB</b>	:
<b>GREGG A. AND SHARON M. GOETTEL</b>	:
<b>CARL I., Jr., AND BARBARA AUSTIN</b>	DECISION
<b>JAMES AND MAUREEN BOWERS</b>	DTA NOS. 823894,
<b>DONALD R. AND SUSAN M. KIMBER</b>	823895, 823896,
<b>DAVID AND KATHLEEN MISNER</b>	823897, 823898,
<b>GARY AND JEAN PETRICK</b>	823899, 823900,
<b>MICHAEL G. D’AVIRRO</b>	823901, AND 824246
<b>WILLIAM T. AND KELLEY L. KRIESEL</b>	:
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 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, and William T. and Kelley L. Kriesel, filed exceptions to the determination of the Administrative Law Judge issued on February 21, 2013. Petitioners appeared by Bousquet Holstein, PLLC (Timothy M. Lynn, Esq. and Paul M. Predmore, 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 exceptions. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument was heard on October 16, 2013 in Albany, New York.

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

### ***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 satisfying the employment test under Tax Law § 14 (b) (1), and thus qualifying 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) or Tax Law § 606 (a) (10) and therefore entitled to the QEZE tax reduction credits or refunds of empire zone wage tax credits, respectively, as claimed.

### ***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge, except for modifications to certain abbreviations. Specifically, we modified the abbreviation of Bowers & Company, CPAs, PLLC from “the MGD/Bowers PLLC” and “Bowers” to “MGD/Bowers,” and the abbreviation of Dermody, Burke & Brown, Certified Public Accountants, P.C. from “Dermody P.C.” to “Dermody.” The Administrative Law Judge’s findings of fact, as modified, appear below:

*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 (MGD/Bowers).<sup>1</sup>

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

3. The single-member MGD/Bowers 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), a New York professional services corporation. Mr. D’Avirro was a partner in P&B. MGD/Bowers was the form of business organization to be used for the combined practice of P&B and Dermody. 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 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 effective July 30, 2002, MGD/Bowers, under the name Michael G. D’Avirro, CPA, PLLC, was

---

<sup>1</sup> 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).

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 MGD/Bowers 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.

7. On December 24, 2002, a second Certificate of Amendment of the Articles of Organization of MGD/Bowers 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 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, MGD/Bowers 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 MGD/Bowers, then operating under the name Dermody, Burke & Brown, Certified Public Accountants, PLLC. Fourteen of the new members had been

shareholders of Dermody and six of the new members had been partners, along with Mr. D'Avirro, in P&B. The former P&B members who joined MGD/Bowers on January 1, 2003 were petitioners Ayoub, Austin, Goettel, Bowers, Kimber, and Petrick.

11. Upon the admission of the 20 new members to MGD/Bowers 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, MGD/Bowers, 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 MGD/Bowers under the name Michael G. D'Avirro, CPA, PLLC (*see* Finding of Fact 4).

13. The January 24, 2003 certification certified MGD/Bowers in connection with a facility located at 126 North Salina Street; that is, P&B's former address. MGD/Bowers 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 MGD/Bowers.

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 who had previously been shareholders of Dermody (Dermody members) had their membership interests in MGD/Bowers redeemed. This left MGD/Bowers 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 MGD/Bowers. 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 MGD/Bowers, would become the EIN of K&S/DBB. At the same time, MGD/Bowers 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 MGD/Bowers, 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 (*see* Finding of Fact 1).

20. MGD/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 MGD/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 MGD/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 MGD/Bowers (*see* Findings of Fact 4 and 12).

24. The MGD/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 accounting practices on January 1, 2003, seven of the petitioners who are now members of MGD/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% 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 who 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 accounting firm was the best candidate to pursue to accomplish the goal of diversifying the services of P&B. Dermody 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 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 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 MGD/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 MGD/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 MGD/Bowers accounting practice rented office space at a new location at MONY Tower in Syracuse, New York. MGD/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. MGD/Bowers provided services for individuals who 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 MGD/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 MGD/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 MGD/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 MGD/Bowers allowed employees to work part-time, have flexible time arrangements, and to work from home. The decision to allow MGD/Bowers employees to work at home was attributable to a substantial investment in technology resources.

43. Post-separation MGD/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 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% of its business attributable to medium and large privately owned businesses and their owners. In contrast, P&B had about 90% of its business attributable to such clients.

45. As a result of these changes in operation between P&B and MGD/Bowers, MGD/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 MGD/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 MGD/Bowers.

47. MGD/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 MGD/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. MGD/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. MGD/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 MGD/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 MGD/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, MGD/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 <sup>2</sup>
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
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

---

<sup>2</sup> 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.

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 MGD/Bowers and unrelated to the present matter. The amount remaining due results from a denial of such credits as related to MGD/Bowers only.

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

#### ***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge initially focused on whether the July 30, 2002 certification of MGD/Bowers is applicable to the post-separation MGB/Bowers. The Administrative Law Judge observed that as of the July 1, 2004 Separation Agreement, the accounting firm that was MGD/Bowers split into two separate accounting firms. Following section 708 of the Internal Revenue Code (26 USC or IRC), the Administrative Law Judge concluded that Dermody continued the former partnership and MGD/Bowers became a new entity for tax purposes. The

Administrative Law Judge determined that as a new partnership, MGD/Bowers was not entitled to rely upon the certification of a prior, albeit former, partnership. Accordingly, the Administrative Law Judge concluded that, for the period at issue, the certification date for the post-separation MGD/Bowers was the August 12, 2004 certification.

The Administrative Law Judge explained that as MGD/Bowers was treated as a new partnership, it did not retain the QEZE attributes of the former organization. Thus, the Administrative Law Judge further determined that MGD/Bowers was properly subject to the new business test because the partnership had a base period of zero years and its employment number was greater than zero during the taxable years at issue (Tax Law § 14 [b] [1]). The Administrative Law Judge observed that, in any event, MGD/Bowers fails the employment test under Tax Law § 14 (b) (1) because the record does not clearly establish that, during the years at issue, the partnership's employment number equaled or exceeded the number during its proposed base period. The Administrative Law Judge also determined that the record failed to establish that MGD/Bowers operated differently than P&B during the period at issue.

Accordingly, the Administrative Law Judge concluded that petitioners failed to prove that they were the owners of a new business for purposes of being entitled to either the QEZE tax reduction credits or the refundable EZ wage tax credits.

#### ***ARGUMENTS ON EXCEPTION***

Petitioners continue to argue on exception that MGD/Bowers is not subject to the new business test set forth in Tax Law § 14 (j) (2) because it was first certified as a QEZE under Article 18-B of the General Municipal Law on July 30, 2002. Petitioners disagree with the Administrative Law Judge's analysis regarding the determination of what constitutes a "business enterprise," an undefined term by either the Tax Law or Article 18-B of the General Municipal



Law. Petitioners argue that, as Tax Law § 14 (a) utilizes the term “business enterprise” rather than taxpayer, the Administrative Law Judge’s analysis based upon income tax reporting classifications is incorrect. In further support of this argument, petitioners assert that certification as a QEZE is a property right that stands separate and apart from the attendant tax benefits.

Petitioners argue that even if it is determined that MGD/Bowers was first certified on August 12, 2004, MGD/Bowers had a base period of greater than zero years and, therefore, is not subject to the new business test.

Finally, petitioners assert that they meet the new business test since, during the tax years in issue, MGD/Bowers operated differently than P&B.

The Division argues that the analysis of the Administrative Law Judge was correct and the determination should be affirmed.

### ***OPINION***

After reviewing the determination and the record herein, we find that the Administrative Law Judge completely and adequately dealt with the issues presented to him. However, we find it necessary to further address the rules of statutory construction regarding the QEZE tax reduction credits (Tax Law §§ 16, 606 [cc]), and refunds of EZ wage tax credits (Tax Law § 606 [k]), claimed by petitioners.

Statutes providing for tax credits are similar to, and should be construed in the same manner as, statutes creating tax exemptions (*Matter of Piccolo v New York State Tax Appeals Trib.*, 108 AD3d 107 [2013]). Such statutes are to be strictly and narrowly construed (*Matter of Mobil Oil Corp. v Finance Adm’r of City of N. Y.*, 58 NY2d 95 [1983]; *Matter of Grace v New York State Tax Commn.*, 37 NY2d 193, 195 [1975], *lv denied* 37 NY2d 708 [1975]), and the burden of proving entitlement to a tax exemption rests with the taxpayer (*Matter of Blue Spruce*

*Farms v New York State Tax Commn.*, 99 AD2d 867 [1984] *affd* 64 NY2d 682 [1984]; *Matter of Young v Bragalini*, 3 NY2d 602 [1958]). Furthermore, to prevail over the construction by the administrative agency charged with its enforcement, the taxpayer must establish not only that its interpretation of the law is a plausible one, but, also, that its interpretation is the only reasonable construction (*Blue Spruce Farms*).

The tax credits sought by petitioners are available through QEZEs (Tax Law §§ 16 [a]; 606 [cc]). Tax Law § 14 (a) provides that a QEZE is a certified “business enterprise,” which is a term undefined in the Tax Law.<sup>3</sup> As pointed out by the Administrative Law Judge, for federal income tax reporting purposes, any noncorporate business entity, such as an LLC, with two or more members may be classified as either a partnership or an association (i.e., treated like a corporation) (Treas Reg § 301.7701-3 [a]). An LLC is not a “business enterprise” because it is not a recognized entity for federal tax reporting purposes. In this case, both the pre-separation and post-separation MGD/Bowers were classified as partnerships for federal and state tax reporting purposes (Tax Law § 601 [f]).

Following this logic, the Administrative Law Judge pointed to 26 USC § 708 (b) (2) (B), which provides that, when a partnership splits into two or more partnerships, it is continued in the successor whose members had an interest of 50% or more in the capital and profits of the prior partnership.<sup>4</sup> Since the MGD/Bowers partners had less than 50% interest prior to the

---

<sup>3</sup> Tax Law § 14 (a) provides: “Qualified empire zone enterprise. A *business enterprise* which is certified under article eighteen-B of the general municipal law prior to July first, two thousand five shall be a ‘qualified empire zone enterprise’” (emphasis added).

<sup>4</sup> 26 USC 708 (b) (2) (B) provides: “In the case of a division of a partnership into two or more partnerships, the resulting partnership (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 the purposes of this section, be considered a continuation of the prior partnership.”

separation, the Administrative Law Judge concluded that they were not a continuation of the prior partnership, but rather constituted a new partnership.<sup>5</sup>

While it would not be unreasonable to construe the term “business enterprise” to mean a legal business entity, as urged by petitioners, under the circumstances of this case, it is also not unreasonable to construe “business enterprise” in accordance with the income tax classification approach of 26 USC § 702, as urged by the Division and adopted by the Administrative Law Judge.

Thus, while we recognize that MGD/Bowers, first certified as a QEZE by the relevant authorities on July 30, 2002, is the same legal business entity of which petitioners were partners during the tax years in issue,<sup>6</sup> this fact does not allow petitioners to prevail in this matter. Petitioners rely upon the Appellate Division decision in *Matter of WL, LLC v Department of Economic Dev.* (97 AD3d 24 [2012], *affd sub nom on other grounds James Sq. Assoc., LP v Mullen*, 21 NY3d 233 [2013]) for the proposition that QEZE certification is independent of the attendant tax credits and benefits, and is, itself, a “property interest that it entitled to due process protection” (*WL, LLC* at 27).<sup>7</sup> That being said, it does not necessarily follow that the certification remains with the legal business entity that initially received it.

---

<sup>5</sup> The Administrative Law Judge noted that pursuant to IRS regulations, this partnership obtained a new federal EIN and filed a separate short taxable year return, whereas the other partners filed an annual return as the surviving partnership.

<sup>6</sup> This is supported, for example, by the uncontroverted fact that, upon the separation of the partnerships, it was the Dermody partners whose interests in the partnerships were redeemed, leaving the MGD/Bowers partners as owners of what would appear under the separation agreement to be the continuing business entity.

<sup>7</sup> It is unclear whether the *WL, LLC* ruling on the independence of QEZE certification from the tax benefits survives the decision in *James Sq.* Affirming strictly on a Due Process analysis rather than a hybrid Due Process/Taking Clause analysis, the Court of Appeals clearly states that the Appellate Division’s characterization of the retroactive application of the statute “as an unconstitutional taking of property” was incorrect, and further states that the “purported taking here is plaintiffs’ obligation to pay tax to the State in the absence of a valid tax credit” (*James Sq.* at 246-47).

Additionally, contrary to petitioners' assertions, we find no intent of the Legislature that is thwarted by the disallowance of the credits claimed by petitioners. It is true that the utilization of the certification date of August 12, 2004, rather than July 30, 2002, effectively provides petitioners with an additional two years of eligibility for various QEZE benefits. However, as we have concluded that petitioners were members of a "business enterprise" initiated in 2004, they are entitled to an eligibility period commencing in 2004. Petitioners have not cited any legislative materials evidencing an alternative intent under these facts.

The Administrative Law Judge's analysis, which was consistent with the Division's position in this matter, cannot be said to be unreasonable. Therefore, while petitioners' argument that MGD/Bowers should be the surviving partnership is not without merit, it cannot be said to be the only reasonable interpretation of the applicable statutes.

Petitioners agree that, even if the certification date was August 12, 2004, MGD/Bowers meets the employment test because it was a disregarded entity in 2002, and treated as a partnership in 2003. They contend that, as these attributes cannot be stripped away, MGD/Bowers did not have zero years in its base period. However, as the Administrative Law Judge concluded that as MGD/Bowers was treated as a newly formed partnership in 2004, it could have no attributes in 2002 or 2003 (i.e., petitioners cannot receive the benefits of QEZE attributes of a partnership to which they do not belong).<sup>8</sup> Again, the Administrative Law Judge's analysis, consistent with the Division's position in this matter, cannot be said to be unreasonable. Thus, petitioners cannot prevail on the issue of having met the employment test.

---

<sup>8</sup> Under 26 USC § 708 (b) (2) (B), the attributes, such as QEZE certification and the pre-separation history of MGD/Bowers, follow the continued partnership, Dermody.

Finally, petitioners argue that they have met the new business test and that MGD/Bowers is not substantially similar in operation to P&B. The Administrative Law Judge, while agreeing that substantial changes in operations appeared to have been made, determined that petitioners had not met their burden of proof to show that such changes were made during the years at issue. In fact, it appeared to the Administrative Law Judge that most of the practical changes were made after the relevant time period. On exception, petitioners have not addressed this failure of proof, and therefore, this argument must fail.

As we noted earlier, statutes authorizing tax credits are strictly construed against the taxpayer, who must demonstrate that the *only* reasonable interpretation of the provision proves entitlement to the exemption (*see e.g. Piccolo; Matter of Brookfield Power New York Corp.*, Tax Appeals Tribunal, November 10, 2010). Such a demonstration is, indeed, a difficult task. While petitioners present reasonable alternative arguments, they have not shown that the Division irrationally interpreted the relevant statutes. More importantly, petitioners have failed to show that their interpretation of the statute is the *only reasonable interpretation* and, accordingly, have failed to demonstrate they are entitled to the subject credits. For that reason, we affirm the determination of the Administrative Law Judge.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions 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, and William T. and Kelley L, Kriesel are denied;
2. The determination of the Administrative Law Judge is affirmed;

3. 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, and William T. and Kelley L. Kriesel are denied; and,

4. The Notices of Deficiency, as listed in Finding of Fact 54, and modified as indicated in Finding of Fact 56, are sustained.

DATED: Albany, New York  
April 16, 2014

/s/ Roberta Moseley Nero  
Roberta Moseley Nero  
President

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

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