STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MARK S. AND MARIA F. PURCELL	:	DECISION DTA NO. 825436
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2008, 2009 and 2010.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on May 21, 2015. The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq. and Christopher O'Brien, Esq., of counsel). Petitioners appeared by Bousquet Holstein, PLLC (Paul M. Predmore, Esq., Philip S. Bousquet, Esq. and Cecelia R.S. Cannon, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioners filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument was heard in Albany, New York on May 12, 2016, which date began the six-month period for the issuance of this decision. Commissioner Scozzafava took no part in the consideration of this matter.

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

ISSUE

Whether, for purposes of computing petitioners' tax reduction credit under Tax Law § 16, the Division of Taxation properly reduced the tax factor component of such credit by reducing the amount of qualified empire zone enterprise income allocated to New York State by applying

the business allocation percentage of Purcell Construction Corporation, a sub-chapter S corporation, to determine such allocated income amount.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. Set forth below are those facts as determined by the Administrative Law Judge that are relevant to the issue raised on exception.[1] We have also made additional findings of fact, numbered 20 and 21 herein, to more fully reflect the record.

1. Purcell Construction Corporation (PCC) is a New York business corporation, formed in 1972, whose sole shareholder is petitioner Mark S. Purcell. PCC's sole New York business office has always been located at 566 Coffeen Street, Watertown, New York.

2. At all times relevant, PCC elected to be taxed as a subchapter S corporation pursuant to the Internal Revenue Code (IRC) and Tax Law § 660. PCC filed a form CT-3-S (New York S corporation franchise tax return) for each of the years 2008, 2009 and 2010 (the years at issue). On page 1, line E, of each of such returns, PCC reported its business allocation percentage (BAP) as follows:

2008 – 44.5624%
2009 – 51.5741%
2010 – 34.3787%

3. Petitioners, Mark S. and Maria F. Purcell, jointly filed a Form IT-201 (New York State resident income tax return) for each of the years 2008, 2009 and 2010. As the sole shareholder

[1] As the Division takes exception to only one of two issues addressed in the determination, facts not relevant to the issue contested on exception are not set forth in this decision. To ensure a complete record, however, the facts not restated herein, numbered 6 through 15, 17, 18 and 32 through 36 in the determination, are incorporated by reference. We note also that the findings of fact numbered 16 and 19 through 31 in the determination have been renumbered as 6 through 19, respectively, in this decision.

of PCC, petitioner Mark S. Purcell reported on such returns all income that flowed through to him from PCC.

4. On December 2, 2003, PCC was certified under Article 18-B of the General Municipal Law as an empire zone enterprise in the City of Watertown empire zone (Watertown empire zone). The certificate of eligibility states that the corporation:

> "is eligible to access the benefits referred to in Section Nine Hundred Sixty Six of the General Municipal Law in connection with the facility(ies) located at 566 Coffeen St., Watertown NY-designated as zone property 10/3/2003 [and] 22643 Fisher Circle, 22686 and 22419 Fisher Road, Watertown, New York-designated as zone property 7/27/1994."

PCC's business office is, as noted above, located at the Coffeen Street premises. Its separate, and only, manufacturing plant is situated in the Jefferson County Industrial Park at the Fisher Circle/Fisher Road premises. PCC does not own or operate any other offices or facilities, either in or out of any empire zone, in New York State.

5. PCC utilizes a vertically integrated structure to conduct (a) general construction activities, (b) construction management activities and (c) design/build construction activities. In design/build construction, PCC provides both the building design and building construction functions, so as to provide its customers with "turnkey" delivery of a given structure ready for occupancy and use. The largest segment of PCC's construction activities are large structure, design/build projects, such as dormitories, barracks, and college residence halls, built using pre-fabricated wall, floor/ceiling and roof panels designed (at PPC's Coffeen Street premises) and manufactured (at PCC's Fisher Circle/Fisher Road premises) in the Watertown Empire Zone. PCC's business model relies on integrating its prefabricated panel system into its design/build construction operations. Its use of the prefabricated panel system for construction, coupled with its ability to self-manufacture the panels for delivery and installation at its job sites, allows for

faster construction. This distinguishes PCC from many other design/build construction companies, and results in a competitive advantage for PCC.

6. None of PCC's design/build construction projects during the years at issue involved job site locations that were within the specifically defined geographic boundaries of the Watertown Empire Zone. At the same time, however, nearly all of PCC's projects in New York State involved job site locations that were within approximately ten miles of the Watertown Empire Zone, including the Fort Drum U.S. Army base located approximately nine miles from the Coffeen Street premises. PCC also performed construction projects outside of New York State during the years at issue including, mainly, projects in the State of Virginia.

7. During the years at issue, PCC was a qualified empire zone enterprise (QEZE), as such term is defined in Tax Law § 14. Petitioners claimed the QEZE tax reduction credit under Tax Law § 16 via form IT-604 (claim for QEZE tax reduction credit) that accompanied their tax returns for each of the years at issue. On line 21 of the Form IT-604 that accompanied petitioners' personal income tax returns for each of the years 2008, 2009 and 2010, petitioners reported the following amounts as "income from the QEZE allocated within NYS" (QEZE income):

2008 – $18,049,295.00
2009 – $22,371,001.00
2010 – $14,662,343.00

8. These amounts were reviewed on audit and modified. By the time of the hearing the parties agreed that the QEZE income amounts for purposes of the tax factor calculation under Tax Law § 16 (f) (2) (c) were as follows:

2008 – $18,358,292.00
2009 – $22,748,381.00
2010 – $14,809,862.00

However, on audit, the Division (over petitioners' objection) applied PCC's BAP (***see*** finding of fact 2) to such amounts in calculating the tax factor for purposes of the QEZE tax reduction credit under Tax Law § 16.

9. The Division selected petitioners' tax return for the year 2009 for audit, and by a letter dated April 11, 2011, requested information concerning PCC's operations so as to verify petitioners' claim for the QEZE tax reduction credit for that year.

10. On November 4, 2011, petitioners supplied such information including (with reservation of all rights) a "hypothetical recalculation of employment numbers" for PCC for 2009. Thereafter, the Division requested additional information and petitioners furnished the same on December 8, 2011.

11. By a letter dated February 1, 2012, the Division provided petitioners with a recalculation reducing the QEZE tax reduction credit claimed by petitioners for 2009, and also requested documentation with respect to petitioners' claimed QEZE tax reduction credit for the years 2008 and 2010.

12. On February 10, 2012, the Division issued to petitioners a statement of proposed audit changes (form DTF-960) for 2009, indicating tax due in the amount of $1,108,178.17 plus interest (to date), for a then-balance due in the amount of $1,270,680.52.

13. On March 1, 2012, petitioners submitted to the Division a letter of disagreement concerning the Division's conclusion for the year 2009, accompanied by a payment check in the amount of $1,270,680.52 and a claim for refund of such amount (plus interest).

14. On March 23, 2012, petitioners supplied the requested information for the years 2008 and 2010, including (again with reservation of all rights) a "hypothetical recalculation of employment numbers" for PCC for 2008 and 2010 with supporting documentation.

15. By a letter dated April 23, 2012, the Division provided petitioners with a recalculation reducing the QEZE tax reduction credit claimed by petitioners for the years 2008 and 2010.

16. On May 1, 2012, the Division issued to petitioners a statement of proposed audit changes (form DTF-960) for 2008, indicating tax due in the amount of $594,219.00, plus interest (to date), for a then-balance due in the amount of $744,205.73.

17. On May 1, 2012, the Division issued to petitioners a statement of proposed audit changes (form DTF-960) for 2010, indicating tax due in the amount of $825,251.39, plus interest (to date), for a then-balance due in the amount of $888,286.03.

18. On May 14, 2012, petitioners submitted to the Division separate letters of disagreement concerning the Division's conclusions for the years 2008 and 2010, accompanied by separate payment checks in the respective amounts of $744,205.73 and $888,286.03, and separate claims for refund of such amounts (plus interest).

19. By a letter dated July 30, 2012, the Division denied petitioners' claims for refund for the years 2008, 2009 and 2010. Petitioners timely challenged such denials by filing a petition with the Division of Tax Appeals, seeking to overturn the Division's disallowance of certain of PCC's employees as in-zone employees for purposes of the zone allocation factor, and the Division's application of the PCC's BAP in calculating petitioner Mark S. Purcell's QEZE income for purposes of computing the tax factor.

20. During the years at issue, PCC performed its design and build construction projects both within and without New York State. Most of PCC's construction projects outside of New York State during those years were performed in Virginia.

21. For each of the years at issue, petitioners claimed a resident credit equal to the amount of income tax that they paid to the state of Virginia. The income upon which such tax was

imposed resulted from the allocation of PCC income to Virginia. The Division did not raise the issue of the resident credit on audit and has not sought to adjust any of petitioners' resident credit claims for the years at issue.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge noted that the QEZE tax reduction credit under Tax Law § 16 provides a credit against a taxpayer's franchise or income tax attributable to QEZE income. He further noted that the tax factor set forth in Tax Law § 16 (f) was a component of the tax reduction credit calculation. The Administrative Law Judge also observed that the specific provision relevant to the present matter states that the tax factor for a resident S corporation shareholder equals the shareholder's New York income tax multiplied by a fraction, the numerator of which is the "shareholder's income from the S corporation allocated within the state" and the denominator of which is the shareholder's New York adjusted gross income (AGI) (Tax Law § 16 [f] [2] [C]). The Administrative Law Judge concluded that, as a New York resident, all of Mr. Purcell's income from PCC was allocated within New York and that therefore, in accordance with the language of the statute, all of that income was properly included in the numerator of the tax factor fraction.

The Administrative Law Judge thus interpreted the phrase "shareholder's income from the S corporation allocated within the state" in Tax Law § 16 (f) (2) (C) to mean income that is subject to tax under Article 22. Consequently, the Administrative Law Judge reasoned, where, as here, the S corporation shareholder is a New York resident, all of the shareholder's income from the S corporation is subject to tax under Article 22 and thus all such income is "allocated within the state." Conversely, where the S corporation shareholder is a nonresident of New York, only income from the S corporation that is New York source income is taxable under Article 22, and

thus only such New York source income would be "allocated within the state" and thereby included in the numerator of the tax factor fraction. Accordingly, the Administrative Law Judge determined that the phrase "shareholder's income from the S corporation allocated within the state" as used in the statute ensures that both residents and nonresidents benefit from the tax reduction credit in a proportionate manner.

The Administrative Law Judge rejected the Division's application of PCC's BAP to Mr. Purcell's PCC income in the numerator of the tax factor fraction. He found no authority under any statute or regulation for the application of the BAP where the QEZE tax reduction credit is claimed by a resident shareholder of an S corporation. The Administrative Law Judge noted that Tax Law § 16 (f) (2) (C) provides for the calculation of the shareholder's tax factor, not the S corporation's tax factor. The Administrative Law Judge thus reasoned, as the shareholder's tax was determined under Article 22, it is improper to use the BAP, a method of income allocation under Article 9-A.

The Administrative Law Judge was unswayed by instructions to form IT-604 (claim for QEZE tax reduction credit) that the Division claims support its interpretation. He found that, to the extent that such instructions support the Division's statutory interpretation in this matter, they add a requirement in tax factor calculations not found in the statute and thus impermissibly expand its plain language. The Administrative Law Judge also noted that certain technical memoranda cited by the Division provide little support to its position as such memoranda make no reference to the use of a BAP in calculating the tax factor for personal income tax taxpayers, including shareholders of S corporations.

The Administrative Law Judge dismissed the Division's argument that petitioners' interpretation would improperly permit taxpayers, such as petitioners, to get multiple credits on

the same income by using the QEZE tax reduction credit and the resident credit available pursuant to Tax Law § 620. He found nothing in the Tax Law that bars a taxpayer's use of both credits.

Given his conclusion in petitioners' favor on the tax factor issue, the Administrative Law Judge determined that petitioners' alternate arguments that the Division's application of the statute violates the equal protection clauses of the United States and New York State constitutions and the dormant commerce clause of the United States Constitution were moot.

SUMMARY OF ARGUMENTS ON EXCEPTION

The Division notes that the statute requires an "allocation" of Mr. Purcell's income from PCC within New York in order to properly calculate the tax factor of the QEZE tax reduction credit. The Division contends, however, that the Administrative Law Judge misinterpreted the relevant provision by concluding that petitioners "allocated" Mr. Purcell's income from PCC within New York as that term is used in the statute.

The Division contends that the Administrative Law Judge's interpretation of Tax Law § 16 (f) (2) (C) runs afoul of the rule of statutory construction that words in a statute are presumed to have a meaning. Specifically, the Division argues that resident taxpayers do not "allocate" their income to New York as such individuals are, by statute, subject to tax on all of their income from everywhere, without allocation. Hence, according to the Division, the phrase "allocated within the state" as interpreted in the determination is meaningless as applied to Mr. Purcell.

The Division asserts that the meaning of the phrase in question is ambiguous and that its meaning must be discerned by reference to analogous words and phrases. Upon review of related QEZE statutes and legislative history, the Division takes the position that "allocated within the state" as used in Tax Law § 16 (f) (2) (C) refers to an apportionment at the entity level. The

Division also contends that its use of PCC's BAP as a method of such apportionment was appropriate.

The Division asserts that the Administrative Law Judge improperly failed to give any weight or deference to its longstanding and consistent interpretation of Tax Law § 16 (f) (2) (C) as set forth in its forms and instructions for the tax reduction credit.

The Division also argues that the Administrative Law Judge's interpretation results in an unreasonable disparity of treatment between Article 22 and Article 9-A taxpayers, for under that interpretation, an Article 9-A taxpayer must apportion its income within and without New York using its BAP.

Finally, the Division contends that petitioners' alternatively-asserted constitutional claims are without merit.

Petitioners contend that the plain language of Tax Law § 16 (f) (2) (C) supports their position, and the Administrative Law Judge's conclusion, that the tax factor of their QEZE tax reduction credit claim should include all of Mr. Purcell's income from PCC, and not merely the portion of such income that is allocable to New York under franchise tax allocation rules. Petitioners thus assert, contrary to the Division's position, that the relevant statute is unambiguous and that, accordingly, there is no need to resort to other means of interpretation.

Petitioners also argue that the Division's position is not entitled to any deference as the issue in the present matter is one of pure statutory construction.

Petitioners agree with the Administrative Law Judge that the phrase "allocated within the state" as used in Tax Law § 16 (f) (2) (C) is necessary to ensure proportional and consistent treatment of resident and nonresident S corporation shareholders. Petitioners contend that the Division's insertion of the BAP into petitioners' tax factor is inconsistent with the statutory

language. They further agree with the Administrative Law Judge's finding that there is no basis for using an Article 9-A allocation method to determine the tax factor for an Article 22 taxpayer. Moreover, petitioners argue, the insertion of the BAP creates disproportionate results, as its use would disproportionately reduce the credit for resident shareholders of S corporations with a high percentage of out-of-state sales. By negatively impacting businesses engaged in such export activities, petitioners contend that the Division's proposed interpretation of the statute runs counter to the economic development policies underlying the empire zones program. Petitioners also assert that the use of the BAP in tax factor calculations would create a mismatch between the tax and credit amounts, contrary to the tax factor's stated purpose, which is an apportionment that "reasonably reflects the portion of the shareholder's tax attributable to the income of the [QEZE]" (Tax Law § 16 [f] [2] [C]).

In response to the Division's argument regarding different tax factor treatment for Article 9-A taxpayers as opposed to Article 22 taxpayers, petitioners contend that the Division's position creates inconsistency among taxpayers claiming the QEZE tax reduction credit. In petitioners' view, a proper reading of Tax Law § 16 (f) (2) places all taxpayers on the same footing because the tax factor equals the taxpayer's New York tax on QEZE income, whether imposed under Article 22 or 9-A.

Petitioners also contrast the language of Tax Law § 16 (f) (2) with Tax Law § 40 in support of their argument that Tax Law § 16 (f) (2) lacks the language necessary to sustain the Division's position herein. Petitioners note that Tax Law § 40, enacted in 2013 (***see*** L 2013, c 68), is a tax reduction credit provision with a tax factor similar to the tax factor in Tax Law § 16 (f) (2) (C). In contrast to the QEZE tax reduction credit, however, Tax Law § 40 (d) (2) (C)

expressly provides for the use of an S corporation's business allocation factor in determining the shareholder's income from the S corporation "allocated within the state."

Petitioners agree with the Administrative Law Judge's conclusion that the language in the Division's forms and instructions does not provide support for the Division's position. Petitioners note that the Division may not create a rule that is unsupported by the statute.

Petitioners also agree with the Administrative Law Judge's conclusion that the QEZE tax reduction credit and the resident credit each serve a legitimate purpose and that their use of both such credits during the years at issue was appropriate.

Finally, petitioners assert that the Division's interpretation of Tax Law § 16 (f) (2) (C) would result in an as-applied violation of petitioners' right to equal protection and would also violate the dormant commerce clause.

OPINION

The Legislature enacted the empire zones program to spur economic growth and job creation. General Municipal Law § 956 contains the following legislative findings:

> "It is hereby found and declared that there exist within the state certain areas characterized by persistent and pervasive poverty, high unemployment, limited new job creation, a dependence on public assistance income, dilapidated and abandoned industrial and commercial facilities, and shrinking tax bases. These severe conditions require state government to target for these areas extraordinary economic and human resource development programs in order to stimulate private investment, private business development and job creation. It is the public policy of the state to offer special incentives and assistance that will promote the development of new businesses, the expansion of existing businesses and the development of human resources within these economically impoverished areas and to do so without encouraging the relocation of business investment from other areas of the state. It is further found and declared that it is the public policy of the state to achieve these goals through the mutual cooperation of all levels of state and local government and the business community."

Under the program, the commissioner of economic development was authorized to certify business enterprises as eligible to receive various tax benefits available only to such certified enterprises (***see*** General Municipal Law § 959 [a]).[2] Pursuant to such authority, PCC was certified as a QEZE on December 2, 2003.

One of the tax benefits available under the empire zones program, the QEZE tax reduction credit under Tax Law § 16, provides for a credit against franchise taxes imposed directly on the QEZE or, where the QEZE is a disregarded or flow-through entity for tax reporting purposes, personal income taxes imposed on its owners (Tax Law § 16 [a]). Where the QEZE is organized as a New York S corporation, the shareholders of the S corporation may apply the credit under Tax Law § 16 against their personal income taxes imposed by Article 22 (***see*** Tax Law §§ 16 [a], [f] [2] [C], 606 [i] [1] [B] [xvi], [cc]).

Pursuant to Tax Law § 16 (b), the amount of the QEZE tax reduction credit "shall be the product of (i) the benefit period factor, (ii) the employment increase factor, (iii) the zone allocation factor and (iv) the tax factor." The proper computation of petitioners' tax factor is the sole issue presented on exception.

Where the QEZE's income flows through to its owners, and the tax credit is to be applied against such owners' personal income tax liability, the tax factor calculation is a two-step process. First, the claimant must calculate his or her tax for the taxable year under Tax Law § 601 (a) through (d) (Tax Law § 16 [f] [1]). Next, the claimant must multiply such tax by a

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[2] Although the empire zones program expired on July 1, 2010, a business enterprise certified pursuant to Article 18-B of the General Municipal Law as of June 30, 2010 may continue to claim the QEZE tax reduction credit for the remainder of its benefit period, so long as it meets the relevant eligibility requirements.

prescribed ratio.[3] The tax factor calculation for an S corporation shareholder, like Mr. Purcell, is specifically described in Tax Law § 16 (f) (2) (C) as follows:

> "Where the taxpayer is a shareholder of a New York S corporation which is a qualified empire zone enterprise, the shareholder's tax factor shall be that portion of the amount determined in paragraph one of this subdivision which is attributable to the income of the S corporation. Such attribution shall be made in accordance with the ratio of *the shareholder's income from the S corporation allocated within the state, entering into New York adjusted gross income*, to the shareholder's New York adjusted gross income, or in accordance with such other methods as the commissioner may prescribe as providing an apportionment which reasonably reflects the portion of the shareholder's tax attributable to the income of the qualified empire zone enterprise. In no event may the ratio so determined exceed 1.0" (emphasis added).

As noted, the Division takes the position that the italicized phrase means that the numerator of the tax factor fraction must equal the shareholder's New York source income from the S corporation. To determine such New York source income, the Division multiplied Mr. Purcell's income from PCC by PCC's BAP. As also noted, petitioners argue in opposition that, because he was a New York resident, the numerator of the tax factor fraction properly includes all of Mr. Purcell's PCC income, and not merely the portion derived from or connected with New York sources. The parties' dispute thus centers on the meaning of the phrase "the shareholder's income from the S corporation allocated within the state" as used in Tax Law § 16 (f) (2) (C).

Resolution of this question is a matter of statutory interpretation, the purpose of which is to ascertain and give effect to the intent of the Legislature (***Patrolmen's Benevolent Assn. of***

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[3] In contrast, where the QEZE is subject to corporate franchise taxes and the tax reduction credit is to be applied against such tax liability, the tax factor is simply the corporation's tax determined as prescribed in Tax Law § 16 (f) (1). During the years at issue, Tax Law § 16 (f) (1) provided that the tax factor was the greater of the corporation's tax determined pursuant to its entire net income base or alternative entire net income base multiplied by an appropriate allocation percentage by which such entire net income or alternative entire net income was allocated within New York (***see*** Tax Law former §§ 210 [1] [a], [c]; 1455 [a], [b] [2]; 1502 [a] [1], [3]). Hence, the type of income allocation that the Division asserts is appropriate in the present matter is built into the QEZE tax reduction credit where the QEZE is a C corporation.

City of N.Y. v City of New York, 41 NY2d 205 [1976] ***citing Matter of Petterson v Daystrom Corp.***, 17 NY2d 32 [1966]). The language of the statute "is the clearest indicator of legislative intent and courts should construe unambiguous language to give effect to its plain meaning" (***Matter of DaimlerChrysler Corp. v Spitzer***, 7 NY3d 653, 660 [2006]). Such language "must be read in [its] context, and words, phrases, and sentences of a statutory section should be interpreted with reference to the scheme of the entire section" (McKinney's Cons Laws of NY, Book 1, Statutes § 97). Where the statutory language is ambiguous, however, extrinsic aids, such as the statute's legislative history, may be used to ascertain legislative intent (***see*** McKinney's Cons Laws of NY, Book 1, Statutes §§ 76, 92; ***Matter of Blau Par Corp***., Tax Appeals Tribunal, May 21, 1992). Ultimately, proper statutory construction focuses on "the precise language of the enactment in an effort to give a correct, fair and practical construction that properly accords with the discernable intention and expression of the Legislature [citation omitted]" (***Matter of 1605 Book Ctr. v Tax Appeals Trib. of State of N.Y.***, 83 NY2d 240, 244, 245 [1994], ***cert denied*** 513 US 811 [1994]).

Tax credit statutes, including the QEZE tax reduction credit at issue, are similar to, and should be construed in the same manner as, statutes creating tax exemptions (***see Matter of Piccolo v New York State Tax Appeals Trib***., 108 AD3d 107 [2013]). That is, such statutes must be strictly construed against the taxpayer (***see e.g. Matter of 677 New Loudon Corp. v State of N.Y. Tax Appeals Trib.***, 19 NY3d 1058 [2012], ***rearg denied*** 20 NY3d 1024 [2013], ***cert denied*** 134 SCt 422 [2013]). However, construction of an exemption or credit statute should not be so narrow as to defeat the provision's settled purpose (***Matter of Grace v New York State Tax***

Commn., 37 NY2d 193, 196 [1975], ***rearg denied*** 37 NY2d 816 [1975], ***lv denied*** 338 NE2d 330 [1975]).

Petitioners have the burden to establish "unambiguous entitlement" to the claimed statutory benefit (***Matter of United Parcel Serv., Inc. v Tax Appeals Trib. of State of N.Y.***, 98 AD3d 796, 798 [2012], ***lv denied*** 20 NY3d 860 [2013]). Indeed, petitioners must prove that the Division's interpretation is irrational and that their interpretation of the statute is the only reasonable construction (***Matter of American Food & Vending Corp. v New York State Tax Appeals Trib***., _ AD3d _ [2016] NY Slip Op 522043 [2016]; ***Matter of Brooklyn Navy Yard Cogeneration Partners, L.P. v Tax Appeals Trib. of State of N.Y.***, 46 AD3d 1247 [2007], ***lv denied*** 10 NY3d 706 [2008]).

We note that we do not defer to the Division's proposed interpretation of Tax Law § 16 (f) (2) (C) as the agency responsible for the administration of the QEZE tax reduction credit, as the Division suggests. As we find that the resolution of the present dispute is a matter of pure statutory construction, such deference is inappropriate (***see Matter of Kurcsics v Mechants Mut. Ins. Co.***, 49 NY2d 451, 459 [1980]).

In accordance with the foregoing principles, and pursuant to the following discussion, we find that the Division's proposed interpretation of Tax Law §16 (f) (2) (C) is reasonable. We conclude, therefore, that petitioners have not met their burden of proof to show that theirs is the only reasonable construction.

As used throughout the Tax Law, to allocate means to apportion or to set apart (***see*** http://merriam-webster.com/dictionary/allocate). Underlying this concept is the presumption that the thing to be allocated is capable of being separated or divided into different parts or categories.

For example, nonresident individuals must set apart or allocate their New York source income (***see*** Tax Law §§ 631, 632). The ratio of such New York source income to the nonresident's total gross income from everywhere, with adjustments not relevant here, determines the nonresident's New York personal income tax (Tax Law § 601 [e]).

New York resident individuals do not allocate their income in determining their tax liability. A New York resident's federal AGI, after certain modifications not relevant here, is the resident's New York AGI (Tax Law § 612) and New York AGI, less New York exemptions and New York deductions, is New York taxable income (Tax Law § 611). Accordingly, New York residents are generally subject to personal income tax on all of their income from everywhere, i.e., both within and without the state. Hence, the direction in Tax Law §16 (f) (2) (C) to allocate income within New York has no application to a resident individual for tax reporting purposes.

Accordingly, if Tax Law §16 (f) (2) (C) is interpreted as requiring a shareholder-level allocation of S corporation income as petitioners propose, the phrase "allocated within the state" as used therein would be superfluous as applied to resident shareholders. This is because, in the language of Tax Law §16 (f) (2) (C), *all* of "the shareholder's income from the S corporation . . . enter[s] into New York adjusted gross income." Given the statutory definition of New York AGI, no other outcome is possible for a resident shareholder. Such a construction is to be avoided, for "[i]t is a well-settled principle of statutory construction that every word in a statute is to be given effect and to be presumed to have some meaning" (***Matter of Friss v City of Hudson Police Dept***, 187 AD2d 94, 96 [3d Dept 1993] McKinney's Cons Laws of NY, Book 1, Statutes § 231; ***see also Matter of Branford House v Michetti***, 81 NY2d 681, 688 [1993]).

The Division's proposed interpretation construes the phrase "the shareholder's income from the S corporation allocated within the state" as referring to the shareholder's share of the S corporation's New York-allocated income. This construction thus presumes that the S corporation's income is allocated within and without New York at the entity level and thereby imbues the phase "allocated within the state" with meaning for both residents and nonresidents. Moreover, this construction does not direct a resident taxpayer to take the meaningless step of allocating his or her income within the state. Accordingly, while the Division's interpretation might appear, at first, to be a less obvious or natural interpretation of the statutory language than that proposed by petitioners, we think it is a reasonable reflection of the legislative intent (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 94 ["The legislative intent is to be ascertained from the words and language used, and the statutory language is generally construed according to its natural and most obvious sense, without resorting to an artificial or forced construction."]).

We disagree with the Administrative Law Judge's finding, and petitioners' contention, that the use of the S corporation's BAP is inconsistent with the language of Tax Law § 16 (f) (2) (C) and that there is no basis in the statute for using an Article 9-A allocation method for an Article 22 taxpayer. As discussed, we find that the Division's construction of Tax Law § 16 (f) (2), which contemplates an entity-level allocation of the income of the enterprise, is reasonable. Considering that such an allocation is required under the statute, the BAP is clearly an appropriate method to do so (***see*** Tax Law former § 210 [1] [a], [3] [a] [2], [10] [a] [ii]). As to the use of the BAP where the taxpayer is subject to tax under Article 22, we observe that Tax Law § 632 (a) (2) provides that the New York source income of a nonresident shareholder of an S corporation must be determined using the allocation rules under Article 9-A (or, where

applicable, former Article 32). Accordingly, we find that the Division reasonably used PCC's BAP to determine the tax factor for petitioners' QEZE tax reduction credit.

In support of their position, petitioners note certain results that flow from their proposed construction of Tax Law §16 (f) (2) (C). Principles of statutory construction favor an interpretation that leads to reasonable results (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 143). Specifically, petitioners observe that resident and nonresident shareholders will receive proportional treatment under their proposed interpretation. That is, the tax factor for both resident shareholders and nonresident shareholders will reflect the full amount of QEZE income that is subject to New York tax. Additionally, petitioners note that, under their proposed construction, the numerator of the tax factor fraction for all taxpayers, whether subject to tax under Article 9-A or Article 22, will include all QEZE income subject to New York tax.

We agree with petitioners that these results are reasonable. We find, however, that the Division's proposed interpretation of Tax Law § 16 (f) (2) (C) also leads to reasonable results. Specifically, under that interpretation, resident and nonresident shareholders will receive an equal benefit. That is, the tax factor for both the resident and the nonresident shareholder includes all S corporation income allocated within New York by application of the BAP. Additionally, the Division's construction of Tax Law § 16 (f) (2) (C) treats all QEZEs equally, irrespective of the form of business organization through which the QEZE operates. In contrast, by including non-New York source income in the numerator of the tax factor fraction, petitioners' proposed construction favors resident individuals who claim the credit through Article 22. Petitioners' construction thus favors QEZEs organized as pass-though and disregarded entities and disfavors C corporations. In our view, a QEZE tax reduction credit that treats QEZEs equally, irrespective

of their organizational form, is reasonable. Such consequences from the Division's proposed interpretation thus weigh against a finding that petitioners' proposed interpretation is the only reasonable one (***see Matter of American Food & Vending Corp. v New York State Tax Appeals Trib***.).

We also disagree with petitioners' assertion that their proposed interpretation, by which the tax factor fraction's numerator equals the resident shareholder's income attributable to his or her income from the S corporation, is consistent with the first sentence of Tax Law § 16 (f) (2) (C) and that the Division's proposed interpretation is not. The sentence in question defines the tax factor as "that portion of the amount determined [under Tax Law § 601 (a) - (d)] which is attributable to the income of the S corporation."

Petitioners' interpretation is contrary to the principle of statutory construction that "sentences of a statutory section should be interpreted with reference to the scheme of the entire section" (McKinney's Cons Laws of NY, Book 1, Statutes § 97). Here, the reference to an attribution in the first sentence of subparagraph C must be read in conjunction with the second sentence of that subparagraph, which defines the attribution. As discussed, we find that the second sentence of that subparagraph requires an allocation of the S corporation's income using its BAP to determine the tax factor. Accordingly, our construction allows all parts of the statute to be harmonized with one another and therefore may be construed as reflecting legislative intent (***see Levine v Bornstein***, 4 NY2d 241, 244 [1958]; McKinney's Cons Laws of NY, Book 1, Statutes §§ 97, 98).

As to petitioners' argument contrasting the language of Tax Law § 16 (f) (2) (C) with that of Tax Law § 40 (d) (2) (C), we acknowledge that the later-enacted Tax Law § 40 (d) (2) (C) (***see***

L 2013, c 68) more clearly expresses the legislative intent to restrict a tax reduction credit to the shareholder's income from the S corporation "allocated within the state" using the corporation's business allocation factor. For the reasons discussed above, we conclude, nonetheless, that Tax Law § 16 (f) (2) (C) similarly restricts the QEZE tax reduction credit.

In reaching our decision in this matter, we note that we have not accorded any weight to the Division's forms and instructions or technical services memoranda related to the tax reduction credit (***see*** IT-604, IT-604-I, TSB-M-06[1]C, TSB-M-06[2]I), as such documents have no legal force or effect (***see*** 20 NYCRR 2375.6 [c], 2375.8 [c])

Regarding petitioners' constitutional claims, while this Tribunal lacks authority to determine the facial constitutionality of statutes, we do have jurisdiction to consider whether tax statutes are constitutional as applied (***see Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003). Accordingly, we next address these claims.

Petitioners contend that the Division's proposed interpretation of Tax Law § 16 (f) (2) (C) improperly treats nonresident shareholders more favorably than resident shareholders and thereby violates petitioners' rights to equal protection under both the United States and New York State constitutions. As petitioners correctly note, under the Division's interpretation, a nonresident shareholder's tax factor will reflect the full amount of New York income tax attributable to the nonresident shareholder's income from the S corporation. This is because the nonresident's income tax liability is limited to New York source income (***see*** Tax Law § 601 [e]). In contrast, a resident shareholder's tax factor will reflect only that portion of the resident's New York income tax attributable to the S corporation's income allocated within New York by application of the corporation's BAP. Accordingly, New York income tax attributable to a

resident shareholder's S corporation income allocated outside of New York is not reduced by the QEZE tax reduction credit under Tax Law § 16.

Such differences notwithstanding, we find that our interpretation of the tax factor treats residents and nonresidents equally because both categories of taxpayers receive the same amount of credit. That is, the tax factor for both the resident and the nonresident shareholder includes all S corporation income allocated within New York by application of the BAP. Without a showing of uneven treatment, there is no equal protection violation (***see Matter of Karlsberg***, Tax Appeals Tribunal, March 1, 2010, ***confirmed Matter of Karlsberg v Tax Appeals Tribunal of State of N.Y.***, 85 AD3d 1347 [2011], ***appeal dismissed*** 17 NY3d 900 [2011]).

Additionally, even if the treatment accorded residents and nonresidents under our interpretation of the statute at issue were considered unequal, petitioners' equal protection claim would fail nonetheless. "[T]he equal protection clause does not prevent State Legislatures from drawing lines that treat one class of individuals or entities differently from others unless the difference in treatment is palpably arbitrary or amounts to an invidious discrimination" (***Trump v Chu***, 65 NY2d 20, 25 [1985], ***appeal dismissed*** 474 US 915 [1985] [internal quotation marks omitted]). Petitioners have made no such showing here.

We also reject petitioners' claim that our interpretation of Tax Law § 16 (f) (2) (C) and its application herein results in a violation of the dormant commerce clause. Petitioners contend that, by restricting the QEZE tax reduction credit to the S corporation's New York income as

determined by application of its BAP, our interpretation imposes a greater tax burden on out-of-state sales than on in-state sales and thereby impermissibly burdens interstate commerce.[4]

The dormant commerce clause "limits state legislation that adversely affects interstate commerce" (***Grand River Enters. Six Nations Ltd. v Pryor*** 425 F3d 158, 168 [2005], ***cert denied*** 549 US 951 [2006]). As noted, we find that the QEZE tax reduction credit, as construed herein, provides an equal benefit to both resident and nonresident shareholders. We also find that any impact on interstate commerce arising from our interpretation of the statute at issue is incidental. This is because the New York income tax imposed on Mr. Purcell that is attributable to PCC's sales in the state of Virginia may be offset by the resident credit available pursuant to Tax Law § 620 in the amount of his Virginia income tax liability. Under these circumstances, the statute is properly upheld unless petitioners establish that "the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefit" (***Pike v Bruce Church, Inc.***, 97 US 137, 142 [1970]). Here, as General Municipal Law § 956, cited above, makes clear, the Legislature's purpose and intent in enacting the enterprise zones program was economic development, a significant public interest. In our view, this public interest outweighs any incidental impact on interstate commerce arising from our interpretation of Tax Law § 16.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

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

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[4] Petitioners' claim is based on the definition of BAP during the years at issue. Commencing in 2007, and continuing through the years at issue, a corporation's BAP was defined as the ratio of its receipts from sales of tangible personal property and services within the state to its receipts from such sales both within and without the state (***see*** Tax Law former § 210 [3] [a] [10] [A] [ii]).

2. The determination of the Administrative Law Judge is reversed with respect to the issue on exception;

3. The petition of Mark S. and Maria F. Purcell is denied with respect to the issue on exception, but is otherwise granted; and

4. Petitioners' refund claims for the years at issue are denied to the extent indicated herein, but are otherwise granted to the extent indicated in the determination of the Administrative Law Judge.

DATED: Albany, New York
November 14, 2016

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

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