STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **HERMAN AND BLIMIE SCHREIBER** for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2014.	DECISION DTA NO. 829244

Petitioners, Herman and Blimie Schreiber, filed an exception to the determination of the Administrative Law Judge issued on January 28, 2021. Petitioners appeared by Barclay Damon LLP (David G. Burch, 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 the exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument was heard by teleconference on January 27, 2022, which date began the six-month period for the issuance of this decision.

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

ISSUES

I. Whether, for purposes of computing the QEZE tax reduction credit for resident shareholders of a New York S corporation, the Division of Taxation properly multiplied the S corporation's business allocation percentage by petitioners' income from the S corporation in calculating the tax factor component of such credit.

II. If so, whether the Division of Taxation's motion for summary determination should be granted.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. Those facts appear below.

1. B&H Foto & Electronics Corp. (B&H Foto) is a New York corporation located in New York City.

2. B&H Foto is taxed under Subchapter S of the Internal Revenue Code.

3. B&H Foto was certified in the North Brooklyn/Brooklyn Navy Yard/East Williamsburg Empire Zone as a qualified empire zone enterprise (QEZE) with an effective date of March 7, 2002.

4. The corporate tax returns filed for B&H Foto for the 2014 tax year included form 1120S (US income tax return for an S corporation), form CT-3-S (New York S corporation franchise tax return), and NYC 3L (New York City general corporation tax return). Petitioners assert that B&H Foto did not file income tax returns with any other state.

5. B&H Foto's relevant CT-3-S included form CT-604 (claim for QEZE tax reduction credit).

6. Petitioners directly and through multiple trusts own 50% of the stock of B&H Foto.

7. Petitioners have represented that all of B&H Foto's employees and assets are situated within the state of New York.

8. Petitioners filed a joint IT-201 (NYS resident income tax return) for the 2014 tax year and claimed the QEZE tax reduction credit as shareholders of B&H Foto's certification as a QEZE. Petitioners' tax factor was computed on their form IT-604 (claim for QEZE tax

reduction credit), which was filed with their IT-201.

9. The calculation of petitioners' benefit period, employment increase and zone allocation factors utilized in petitioners' 2014 tax return for calculation of their relevant QEZE tax reduction credit were not challenged by the Division of Taxation (Division).

10. Petitioners calculated their tax factor component of the QEZE tax reduction credit without utilization of the B&H Foto's business allocation percentage (BAP).

11. The BAP of B&H Foto for the 2014 tax year as reported on its 2014 CT-3-S-ATT (attachment to form CT-3-S) was 17.74%.

12. On audit, the Division applied the BAP of B&H Foto as a component of petitioners' tax factor calculation, and reduced petitioners' QEZE tax reduction credit claimed from $292,912.00 to $51,961.00.[1]

13. The Division sent petitioners a letter, dated March 6, 2017, informing petitioners that their QEZE tax reduction credit had been reduced. The Division sent petitioners an account adjustment notice, dated April 13, 2017, informing petitioners that their refund sought was reduced from $1,762,187.00 to $1,521,236.00.

14. On March 6, 2019, petitioners filed a petition seeking a refund relating to the Division's reduction of petitioners' QEZE tax reduction credit.

15. On June 5, 2019, the Division filed an answer in response to the petition.

16. The Division filed a motion, dated October 2, 2020, seeking an order granting summary determination in the above-referenced matter pursuant to section 3000.9 (b) of the Rules of Practice and Procedure of the Tax Appeals Tribunal (Rules). Included with the motion

[1] We have corrected an apparent typographical error in the determination stating that the credit claimed was reduced to $51,768.00.

was the affirmation of Christopher O'Brien, Esq., and the affidavit of the Division's Tax Technician IV, Fredrick Houser.

17. Petitioners filed a response, dated October 30, 2020, to the Division's motion, asserting that the Division's adjustments to petitioners' tax factor was inappropriate and thus summary determination was unwarranted. Included with the response was the affirmation of David G. Burch, Jr., Esq.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Relying on ***Matter of Purcell v New York State Tax Appeals Trib.*** (167 AD3d 1101 [3d Dept 2018], ***lv denied*** 33 NY3d 913 [2019], ***appeal dismissed*** 33 NY3d 999 [2019]), the Administrative Law Judge concluded that the Division properly reduced petitioners' QEZE tax reduction credit by applying B&H Foto's business allocation percentage to petitioners' tax factor calculation. The Administrative Law Judge rejected petitioners' contention that factual differences between ***Purcell*** and the present matter require a different result, even if B&H Foto had business operations in New York only, as claimed. The Administrative Law Judge also rejected petitioners' contention that the use of an S corporation's BAP to determine a shareholder's tax factor in computing the QEZE tax reduction credit is inconsistent with the relevant tax forms for that credit. The Administrative Law Judge found that such forms are generally accorded limited weight, especially so here, given the precedent of ***Purcell***.

ARGUMENTS ON EXCEPTION

Petitioners contend that the determination misinterprets the language of Tax Law § 16 to require the application of B&H Foto's BAP in the calculation of the tax factor component of the QEZE tax reduction credit. Petitioners assert that the tax factor formula in the statute makes no reference to the BAP. Petitioners note that, as New York residents, all their income from B&H

Foto is subject to New York personal income tax. Petitioners thus contend that the application of B&H Foto's BAP in connection with the tax reduction credit does not provide an apportionment reasonably reflecting their New York income tax attributable to their share of B&H Foto's income.

Petitioners argue that the Administrative Law Judge misconstrues ***Purcell*** to mean that an S corporation's BAP must be included as a factor in the calculation of the QEZE tax reduction credit in all circumstances. Petitioners contend that factual differences between ***Purcell*** and the present matter require a different result. Specifically, petitioners note that the S corporation in ***Purcell*** received income from construction projects in Virginia. In contrast, petitioners assert that all of B&H Foto's assets and employees are situated in New York and thereby assert that all its income in 2014 was earned from economic activity in New York State. Petitioners assert that B&H Foto's relatively low BAP of 17.74% reflects the sale and shipment of goods to out-of-state purchasers. Petitioners also note that, while the taxpayers in ***Purcell*** claimed resident tax credit equal to the amount of income tax paid to Virginia, petitioners here received no resident credit based on the income of B&H Foto. Given these differences, petitioners assert that, although the use of the BAP to limit the QEZE tax reduction credit was appropriate in ***Purcell***, it is not appropriate here.

Petitioners contend that a rule requiring the application of the BAP in all cases is inconsistent with the language of Tax Law § 16. Petitioners assert that the tax factor provision contains no requirement to exclude tax on income from sales outside New York and does not require the application of the BAP. Petitioners contend that the tax factor provision looks to the shareholder's, and not the corporation's, portion of income that is allocated to New York. Petitioners note that, as New York residents, all their income from the S corporation is subject to

New York income tax. Petitioners argue, accordingly, that their QEZE tax reduction credit should similarly be based on all their income from the S corporation, not from their share of S corporation income multiplied by the S corporation's BAP, as proposed by the Division.

Petitioners observe that form CT-604, by which corporations claim the QEZE tax reduction credit, does not request the BAP or BAP-related information, and does not require such information to be reported to shareholders for their tax reduction credit calculations.

Petitioners also assert that the Division's position in the present matter is contrary to its prior interpretation of the statute in a technical memorandum, which states that the "income from the QEZE S corporation allocable to New York State is the QEZE S corporation income from New York state sources" (TSB-M-06[1]C *Qualified Empire Zone Enterprise [QEZE] Tax Credits* [February 2, 2006], p 18). Petitioners observe that the memorandum does not assert that BAP should be a factor in calculating the tax reduction credit.

Additionally, petitioners contend that the determination's application of the BAP in the calculation of the tax factor undermines the express public policy of the QEZE program to encourage businesses to create employment and to invest in economically depressed areas. Petitioners assert that the goal of the tax reduction credit was to potentially eliminate all tax liability generated by such a business. Petitioners argue that, contrary to that policy and goal, the determination effectively excludes tax attributable to revenue derived from employment and operations in the Empire Zone from the tax reduction credit.

Petitioners note that issues of fairness and the misuse of tax credits are legitimate concerns. They contend, however, that the fairness issue in ***Purcell***, arising from the taxpayer therein claiming a resident credit on tax paid on the same income for which a tax reduction credit was claimed, is not present here. Petitioners assert that the tax reduction credit's zone allocation

factor (Tax Law § 16 [e]) provides an appropriate means to account for assets and locations outside of an empire zone.

In their reply brief, petitioners alternatively assert that, if an allocation is made at the QEZE level here, the allocation should be 100% because B&H Foto has no assets or employees outside New York State and 100% of petitioners' income from B&H Foto is included in their New York adjusted gross income. Petitioners assert that such an allocation reasonably reflects that portion of their New York income tax liability attributable to B&H Foto.

The Division contends that the Administrative Law Judge properly found that ***Purcell*** is controlling in the present matter and that the holding in that case requires an S corporation shareholder's QEZE tax reduction credit calculation to use the S corporation's BAP in computing the tax factor. The Division thus argues that ***Purcell*** is not limited to the circumstances of that case. The Division also asserts that, although referenced in ***Purcell***, the claim of a resident credit is not relevant in computing the QEZE tax reduction credit. Additionally, the Division contends that the technical memorandum cited by petitioners does not undermine its position in the present matter. Finally, the Division asserts that its proposed method of computing the tax reduction credit herein is not contrary to the legislative intent underlying QEZE program.

OPINION

As a certified QEZE, B&H Foto was eligible to receive certain tax benefits available to such certified business enterprises (***see*** General Municipal Law § 959 [a]).[2] One of those

[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.

benefits, the QEZE tax reduction credit, provides for a credit against 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]).

The amount of the QEZE tax reduction credit is "the product of (i) the benefit period factor, (ii) the employment increase factor, (iii) the zone allocation factor and (iv) the tax factor" (Tax Law § 16 [b]). The present matter concerns only the proper computation of the tax factor.

Where, as here, the QEZE is a New York S corporation and the tax reduction credit claimant is an S corporation shareholder, Tax Law § 16 (f) (2) (C) describes the tax factor calculation 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 [taxpayer's New York income tax for the taxable year] 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."

Our interpretation of Tax Law § 16 (f) (2) (C) is guided by the following well-established rules of statutory construction:

> "[A] tax credit is a form of exemption from taxation. Statutes creating exemptions must be strictly construed against the taxpayer and, if ambiguity arises, against the exemption, although such statutes should not be interpreted so narrowly as to defeat their settled purposes. A taxpayer seeking an exemption from taxation bears the burden of proving an unambiguous entitlement thereto, showing that the proffered interpretation of the statute is not only plausible, but also that it is the only reasonable construction . . . When engaging in statutory interpretation, all provisions of a statute must be read and construed together, and words within a provision are not to be rejected as superfluous when they may instead be given a distinct and separate meaning" (***Matter of Purcell v New York***

> ***State Tax Appeals Trib.*** (167 AD3d at 1103 [internal quotation marks and citations omitted]).

We agree with the Division that ***Purcell*** is controlling in the present matter. We affirm the determination of the Administrative Law Judge accordingly.

The taxpayer in ***Purcell*** was a resident shareholder of a QEZE S corporation engaged in the business of constructing commercial buildings, primarily in New York and Virginia, using prefabricated systems that it manufactured in the empire zone in which it was certified (167 AD3d at 1105). The question in ***Purcell*** was the same as the question presented here, that is, does Tax Law § 16 (f) (2) (C) "require . . . allocation of a New York S corporation's income for resident shareholders based on the BAP reported by the corporation" (***id***.).[3] ***Purcell*** finds that such an interpretation gives meaning to all the words in Tax Law § 16 (f) (2) (C), consistent with the rules of statutory construction, and concludes that this interpretation is "rational" (***id.***; ***see also*** McKinney's Cons Laws of NY, Book 1, Statutes § 231).

Purcell expressly rejects the interpretation of Tax Law § 16 (f) (2) (C) advanced by petitioners in the present matter, i.e., that all of a resident shareholder's income from an S corporation is properly included in the numerator of the tax factor fraction. This proposed interpretation is deemed "facially implausible and unreasonable" because it "impermissibly render[s]" the phrase "allocated within the state" as used in Tax Law § 16 (f) (2) (C) superfluous or meaningless (***id.*** at 1104). Petitioners have offered no alternative interpretation of this phrase.

Purcell also finds support for its holding in the results of this interpretation of Tax Law

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[3] During the period at issue in ***Purcell*** (2008-2010) and the year at issue here (2014), the BAP was defined, generally, as the ratio of New York-allocated business receipts to total business receipts (Tax Law former § 210 [3] [a] [10] [A] [ii]). For BAP purposes, receipts from sales of tangible personal property were generally allocated based on the location of the purchaser and receipts from sales of services were generally allocated based on the place of performance (***see*** Tax Law former § 210 [3] [a] [2] [A], [B]).

§ 16 (f) (2) (C) (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 143 [principles of construction favor interpretations that lead to reasonable results]). Specifically, the decision observes that nonresident shareholders must allocate their S corporation income to New York by application of the corporation's BAP (167 AD3d at 1105; ***see also*** Tax Law § 632 [a] [2]). The decision notes favorably that an allocation of a resident shareholder's income from the S corporation via the S corporation's BAP thus results in equal benefits for both resident and nonresident shareholders (***id.*** at 1104). The decision also notes favorably that its holding ensures that QEZE tax reduction credits for S corporation shareholders is based only on income earned by the corporation in New York (***id.*** at 1105). The decision also states that "[i]t would be irrational to conclude that the statute – which expressly limits QEZE tax reduction credits to New York activity that occurs within empire zones [i.e., the zone allocation factor] – permits such credits to be based on income realized from out-of-state operations" (***id.*** at n 3).

Petitioners seek to distinguish ***Purcell*** on the facts, contrasting the Virginia business activity of the S corporation in that case with the lack of any out-of-state operations for B&H Foto here. This line of argument is unavailing. As discussed, ***Purcell*** holds that the language of Tax Law § 16 (f) (2) (C) requires allocation of an S corporation's income based on the corporation's BAP when computing the tax factor for a resident shareholder. As noted, the BAP was based solely on business receipts during the period at issue in ***Purcell*** and the year at issue here (***see*** Tax Law former § 210 [3] [a] [10] [A] [ii]). Hence, ***Purcell*** is not distinguishable based on the location of the S corporation's assets and employees.

Indeed, ***Purcell*** implicitly rejects petitioners' alternative argument that B&H Foto's operations, i.e., its assets and employees, should determine any allocation for purposes of the tax reduction credit. By this argument, petitioners propose a tax factor allocation premised on different economic factors than the receipts-based BAP. The BAP, however, was deemed rational in ***Purcell***. While petitioners' proposed allocation method may be plausible, petitioners must show that their interpretation of the statute at issue is "the only reasonable construction" (***id.*** at 1103). ***Purcell*** shows that petitioners have not met their burden.

Petitioners observe, correctly, that the taxpayer in ***Purcell*** claimed resident credits for income taxes paid to Virginia attributable to corporate income derived from construction projects in Virginia. Petitioners contend that this fact created issues of fairness and misuse of tax credits in that case that are not present here and thus justify a different result. We disagree. As noted, ***Purcell*** analyzes Tax Law § 16 (f) in accordance with principles of statutory construction and does not rely on the fact of the resident tax credits in reaching its holding.

Given the precedent of ***Purcell***, we accord petitioners' arguments regarding its form CT-604 and the technical memorandum addressing QEZE tax credits little weight (***see also*** 20 NYCRR 2375.6 [c] and 2375.8 [c]). Additionally, we find that ***Purcell*** refutes petitioners' public policy argument.

As noted, the exception in the present matter arises from a motion for summary determination. Such a motion "shall be granted if, upon all the papers and proof submitted, the administrative law judge finds that it has been established sufficiently that no material and triable issue of fact is presented" (20 NYCRR 3000.9 [b] [1]). We agree with the Administrative Law Judge that, even if petitioners had established their factual claim that all of B&H Foto's assets

and employees were in New York in 2014, that fact would not change our decision. Accordingly, we find that there is no material issue of fact in the present matter and that the Administrative Law Judge properly issued his determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Herman and Blimie Schreiber is denied;

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

3. The petition of Herman and Blimie Schreiber is denied; and

4. The Division's March 6, 2017, letter, denying in part petitioners' claim for credit or refund, is sustained.

DATED: Albany, New York
April 21, 2022

/s/ Anthony Giardina
Anthony Giardina
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Cynthia M. Monaco
Cynthia M. Monaco
Commissioner