STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOHN AND KATHLEEN KING	:	DETERMINATION DTA NO. 825666
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2009, 2010 and 2011.	:	

Petitioners, John and Kathleen King, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2009, 2010 and 2011.

On July 16, 2014 and July 17, 2014, respectively, petitioners, appearing by Citrin Cooperman (Harvey L. Wahrman, Esq., of counsel) and the Division of Taxation, appearing by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by March 16, 2015, which date began the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly disallowed petitioners' claims for qualified Empire Zone credits on the basis that certain payments of taxes were not "eligible real property taxes," as defined by Tax Law § 15(e).

FINDINGS OF FACT

1. John and Kathleen King (collectively, petitioner[1]) conducted business in New York State during the years 2009, 2010 and 2011 (audit period). Petitioner was the controlling shareholder of a group of subchapter S corporations consisting of J. King Realty, Inc. (RealtyCo); J. King Food Service Professionals, Inc. (JKFS); and Crown I Enterprises, Inc. (Crown). These companies are referred to as the King Group.

2. During the audit period, petitioner owned 100% of RealtyCo, 85% of JKFS (the remaining 15% was owned by petitioner's children) and 100% of Crown. RealtyCo earned rental income from real property located in New York State; JKFS was a food distribution company and Crown was engaged in the wholesale grocery business.

3. The King Group elected for federal and New York income tax purposes to be treated as subchapter S corporations pursuant to 26 USC § 1362, allowing for the pass-through of items of income, loss, deduction and credits to the King Group owners.

4. Crown is a wholly-owned qualified subchapter S subsidiary of JKFS.

5. In June 2008, RealtyCo purchased the premises at 85 Saxon Avenue, Bayshore, New York (the property). As part of its acquisition of the property, on June 30, 2008, RealtyCo borrowed $9,750,000.00 from Capital One Bank.

6. Eight months earlier, on November 1, 2007, RealtyCo, as landlord, and Crown, as tenant, executed a written lease agreement for the property with a term of 10 years and 11 months. Pursuant to section 9 of the lease agreement, Crown was required to make monthly

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[1]John King held the interests in the companies in issue. Kathleen King is a named petitioner due to the couple's joint filing status and her inclusion on the notice of deficiency, statement of proposed audit changes and adjustment notices.

payments to RealtyCo, which included an amount equal to the real property taxes for the property.

7. Section 9 of the lease agreement stated that Crown was solely responsible for the payment of all real estate taxes levied or assessed against the property. In fact, said property taxes became a lien against the property during the audit period. Despite Crown's payment of tax with its rent payments, section 8 of the lease provided that only RealtyCo had the discretion to contest any real estate tax assessment and retained all rights to any moneys recovered thereby.

8. Section 26 of the mortgage and security agreement between RealtyCo, as mortgagor, and Capital One, N.A., as mortgagee, specified that RealtyCo would pay one twelfth of the total annual taxes in addition to the principal and interest due each month. The mortgagee was obligated to hold the sums paid for real estate taxes in an escrow fund (established at the closing, per the closing documents in the record) and use them to pay the taxes as they became due and payable. If a deficiency in the escrow fund to pay taxes occurred, RealtyCo agreed to pay such deficiency upon five days notice from the mortgagee, or face the whole of the principal outstanding and any accrued interest becoming due and payable at the discretion of the mortgagee.

9. On November 18, 2008, the property was designated as part of the Islip Empire Zone. On December 30, 2008, Crown was certified under Article 18-B of the General Municipal Law as a qualified empire zone enterprise (QEZE), operating within the Islip Empire Zone during the audit period.

10. All required real estate taxes were paid by Capital One in a timely manner during the audit period with respect to the property. The funds were paid by RealtyCo with its mortgage payments and deposited into an escrow account established by RealtyCo and Capital One. For

each of the years in the audit period, receipts for the taxes paid by Capital One from the escrow account were issued to RealtyCo by the Town of Islip and noted that payment had been received from Capital One Bank.

11. During the audit period, pursuant to the terms of the lease, Crown made a monthly payment to RealtyCo in the sum of $22,050.00, of which $14,229.97 was allocated to rent and $7,820.03 to real property taxes.

12. The real property tax payments were not reflected on the books or tax returns of RealtyCo during the audit period. Instead, RealtyCo only recorded the gross rental income payments of $22,050.00, which included both the rent and taxes. However, RealtyCo did pay one twelfth of the real property taxes with its monthly mortgage payment that was placed in the bank's escrow account.

13. Petitioner timely filed joint New York State personal income tax returns for the years 2009, 2010 and 2011and claimed 85% of the real property tax credit (RPTC) as an 85% shareholder of JKFS, which owned 100% of Crown.

14. Upon audit, the Division disallowed petitioner's RPTC for all three years in the audit period. For the year 2009, the Division determined that Crown was not the entity that made the payment to the taxing authority, nor did it receive a receipt for payment of same from the taxing authority. It was determined that the payments were made by a separate and distinct corporation, RealtyCo, and the credits were denied pursuant to the terms of Tax Law § 15. On November 23, 2013, the Division issued to petitioner a statement of proposed audit changes that recomputed the tax due for 2009 in the sum of $58,563.99 plus interest. A notice of deficiency was issued on January 9, 2013 asserting additional tax due in the same amount plus interest.

15. For the years 2010 and 2011, the Division made adjustments to petitioner's returns based on its determination that Crown had erroneously claimed the QEZE credit for real property taxes. For 2010, after accounting for the denied real property tax credits, the Division adjusted the refund claimed from $92,659.00 to $20,132.30. For 2011, following the denial of the RPTCs associated with Crown, the Division reduced the refund requested from $30,279.00 to $0.00, and reduced the overpayment to be carried forward to the next year from $186,000.00 to $136,515.00. Thus, for years 2010 and 2011, the refunds requested by petitioner on his returns were denied, in part for the year 2010 and in full for the year 2011. These refund denials were properly challenged in petitioner's petition herein.

16. Petitioner filed a request for conference in the Bureau of Conciliation and Mediation Services (BCMS) and then withdrew the request on May 9, 2013. Petitioner filed a petition with the Division of Tax Appeals, challenging the notice of deficiency issued with respect to 2009, and also disputing the account adjustments, or refund denials, made for 2010 and 2011.

SUMMARY OF PARTIES' POSITIONS

17. Petitioner argues that Crown was the entity that paid the real property taxes under its lease with RealtyCo and therefore qualifies for the RPTCs.

18. Petitioner believes that Crown's tax payment never became the property of either RealtyCo or Capital One. He believed those entities only acted as Crown's agent in facilitating the payment of the tax to the municipality. Petitioner maintains that, when the lease and mortgage documents are read together, it is apparent that Crown made the payments of real property taxes directly to the taxing authority.

19. Petitioner also argues that he relied in good faith on his interpretation of the effect of the lease and mortgage documents on his claim for the RPTCs and believes that New York State

or the Town of Islip was aware of his reliance on this interpretation and were under a duty to inform petitioner that this transactional structure would not qualify Crown for the RPTCs, leading petitioner to detrimentally rely on this silence. Based on this detrimental reliance and the pecuniary damages caused thereby, petitioner believes the Division should be estopped from denying the credits.

20. The Division points out that Crown did not pay the taxes directly to the municipality and received no receipts as required by the clear language of the statute. The Division notes that Crown paid the taxes to RealtyCo as required by the lease, which were then paid to Capital One, with the mortgage payments and deposited into the bank's escrow account to satisfy the mortgage provision that obligated RealtyCo to pay the real property taxes due. Thus, the Division contends that Crown never paid the taxes directly to the municipality and never received a receipt.

CONCLUSIONS OF LAW

A. During the years in issue, Tax Law § 15 provided for a credit for the taxes imposed pursuant to Tax Law Articles 9-A, 22, 32 and 33 for "eligible real property taxes" paid or incurred by a QEZE. Tax Law § 15(b) states that the amount of the credit is the product of the benefit period factor, the employment increase factor and the eligible real property taxes paid or incurred by the QEZE during the taxable year. Tax Law § 16 provides for the QEZE tax reduction credit against corporate and personal income taxes of a QEZE and shareholders of New York S corporations that are QEZEs.

B. The issue here is whether Crown's payments of sums included in its lease payments to RealtyCo constitute "eligible real property taxes" as described in Tax Law § 15(e). During the period in issue, this section provided, in part:

> "Eligible real property taxes. The term 'eligible real property taxes' means taxes imposed on real property which is owned by the QEZE and located in an empire zone with respect to which the QEZE is certified pursuant to article eighteen-B of the general municipal law, provided such taxes are paid by the QEZE which is the owner of the real property or are paid by a tenant which either (i) does not meet the eligibility requirements under section fourteen of this article to be a QEZE or (ii) cannot treat such payment as eligible real property taxes pursuant to this paragraph and such taxes become a lien on the real property during a taxable year in which the owner of the real property is both certified pursuant to article eighteen-B of the general municipal law and a qualified empire zone enterprise. *In addition, 'eligible real property taxes' shall include taxes paid by a QEZE which is a lessee of real property if the following conditions are satisfied: (1) the taxes must be paid by the lessee pursuant to explicit requirements in a written lease executed or amended on or after June first, two thousand five, (2) such taxes become a lien on the real property during a taxable year in which the lessee of the real property is both certified pursuant to article eighteen-B of the general municipal law and a qualified empire zone enterprise and (3)* ***the lessee has made direct payment of such taxes to the taxing authority and has received a receipt for such payment of taxes from the taxing authority****.* In addition, the term 'eligible real property taxes' includes payments in lieu of taxes made by the QEZE to the state, a municipal corporation or a public benefit corporation pursuant to a written agreement entered into between the QEZE and the state, municipal corporation, or public benefit corporation" (emphasis added).

C. Since petitioner is seeking tax credits, he bears the burden of proving through clear and convincing evidence that the exemption applies and that they are entitled to the statutory benefit (***see e.g. Matter of Golub Serv. Sta. v. Tax Appeals Trib.***, 181 AD2d 216 [1992]). Tax credits, such as those at issue, are a particularized species of exemption from tax (***Matter of Marriott Family Rests. v. Tax Appeals Trib. of State of N.Y.***, 174 AD2d 805 [1991], ***lv denied*** 78 NY2d 863 [1991]). "Statutes creating tax exemptions must be construed against the taxpayer" (***Matter of Federal Deposit Ins. Corp. v. Commissioner of Taxation & Fin.***, 83 NY2d 44, 49 [1993] [internal quotation marks and citation omitted]; ***Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193 [1975], ***rearg denied*** 37 NY2d 816 [1975]). It must be noted that in matters of statutory interpretation, the cardinal function is to effectuate the intent of the Legislature (***see Matter of Yellow Book of N.Y., Inc. v. Commissioner of Taxation & Fin.***, 75

AD3d 931 [2010], ***lv denied*** 16 NY3d 704 [2011]). The statutory language is the clearest indicator of legislative intent (***Matter of Lewis Family Farm, Inc. v. New York State Adirondack Park Agency***, 64 AD3d 1009 [2009]). Further, the taxpayer must show that its interpretation of the statute is the only reasonable construction ***(Matter of CBS Corporation v. Tax Appeals Tribunal***, 56 AD3d 908 [2008]). For the reasons set forth below, it is concluded that petitioner has not done so.

D. In this matter, although Crown satisfied the first two requirements for a lessee to demonstrate payment of "eligible real property taxes," it did not make direct payment of any taxes to the taxing authority and never received a receipt for such alleged payment. Instead, petitioner argues that Crown's obligation under its lease with RealtyCo to pay the real property taxes to RealtyCo as part of its lease payments satisfied the requirement of Tax Law § 15(e), believing that as lessee under its lease with RealtyCo it somehow acquired RealtyCo's rights and obligations under RealtyCo's mortgage with Capital One, thus becoming the direct payor of the property taxes to the municipality and somehow obviating the need to be issued a receipt for its payment from the municipality. As creative as this interpretation may be, it renders the statutory language meaningless.

In an analogous set of circumstances presented in ***Matter of The Golub Corporation v. Tax Appeals Tribunal*** (116 AD3d 1261 [2014]), the Appellate Division grappled with the issue of whether the payment of taxes by a sub-lessee pursuant to a payment in lieu of taxes agreement (PILOT), to which the sub-lessee was not a party, qualified for a real property tax credit under Tax Law § 15(e). The sublease specifically obligated Golub to make the PILOT payments and

Golub subsequently applied for the empire zone tax credits. The Court, in confirming the decision of the Tax Appeals Tribunal, decided that Golub did not qualify for the credit because the payments were not made pursuant to a written agreement between the QEZE and the appropriate entity, or taxing authority, as specifically required by Tax Law § 15(e). In language of import herein, the Court stated that "[a]lthough petitioner's separate agreement with FM Ventures provided that petitioner would make the payments and the various entities may have desired to structure the transactions so that petitioner could receive the empire zone credit, unfortunately petitioner's PILOT payments do not qualify for such credit under the statutory language (***Id***. at 1262-1263)."

Similarly, the lease between RealtyCo and Crown required payment of the real property taxes on the leased premises by Crown. However, the mortgage between RealtyCo and Capital One required RealtyCo to pay all taxes due on the property, and the lease provisions did not act to transform Crown into the mortgagor under the terms of the mortgage between RealtyCo and Capital One, or treat the taxes paid by RealtyCo with its mortgage payments, which were ultimately paid into the bank's escrow account, as payments by Crown. The tax bills clearly show that the bank made the actual payments to the municipality and the receipts were issued to RealtyCo. Petitioner was not a party to the mortgage and did not make any payments into the bank's tax escrow account. Petitioner's attempt to establish Crown as the party that actually paid the real property taxes is an unpersuasive attempt to tailor the facts to the statutory requirements of Tax Law § 15. Since Crown clearly did not make direct payment of such taxes to the taxing authority and did not receive a receipt for such payment, it is not eligible for the credit.

Even the lease acknowledged RealtyCo's ultimate control over the real property taxes, illustrated in section 8, which provided that only RealtyCo had the discretion to contest any real estate tax assessment and retained all rights to any moneys recovered thereby.

The Court in ***Golub*** made the following statement which is pertinent here: "We cannot, under long settled principles of statutory interpretation, essentially rewrite an unambiguous provision of a statute by ignoring explicit language, no matter how equitable such a result may appear (***Id***. at 1263)."

The statute is clear and unambiguous and there is no basis for permitting a credit to a party that neither paid the tax to the taxing authority nor received a receipt therefor.

E. The ***Golub*** Court's refusal to apply equity in the face of an unambiguous provision of a statute provides a fitting response by this forum to petitioner's prayer for equitable relief herein. Petitioner believes that the theory of detrimental reliance should be relied upon to estop the Division from denying Crown's real property tax credits. However, the facts do not support such a conclusion.

The Tribunal stated in ***Matter of Parvinder Singh Salh*** (Tax Appeals Tribunal, February 25, 2010), as follows:

> "As a general proposition, unless there are exceptional facts which require its application to avoid a manifest injustice, the doctrine of estoppel does not apply to governmental acts (***Matter of Consolidated Rail Corp.***, Tax Appeals Tribunal, August 24, 1995, ***confirmed*** 231 AD2d 140 (1997), appeal dismissed 91 NY2d 848 (1997); ***Matter of Harry's Exxon Service Station***, Tax Appeals Tribunal, December 6, 1988). This proposition is considered especially strong where a taxing authority is involved, since public policy supports the enforcement of the Tax Law (***Matter of Glover Bottled Gas Corp***., Tax Appeals Tribunal, September 27, 1990). The Tax Ap

determine whether to invoke an estoppel, as follows: (i) whether there was a right to rely on a representation made by the Division, (ii) whether there was such reliance and (iii) whether the reliance was to the detriment of the party who relied upon the representation (***see Matter of Consolidated Rail Corp.***; ***Matter of Harry's Exxon Service Station***)."

In ***Salh***, the Tribunal concluded that the petitioner failed to establish that he relied upon the representations made by the Division and that the reliance was to his detriment. The same conclusion is reached herein.

Tax Law § 15(e), which required a lessee to both pay the real property taxes directly to the taxing authority and receive a receipt therefor, was enacted in 2005. Charged with knowledge of this law, petitioner crafted the lease between Crown and RealtyCo in 2007. The lease required Crown to pay the real property taxes, which would have satisfied the provision of Tax Law § 15(e) if Crown had paid the taxes to the taxing authority directly and received a receipt therefor.

However, in 2008, RealtyCo purchased the property, for reasons undisclosed in the record, and executed both a mortgage and a consolidation, modification and extension agreement with Capital One Bank, the latter also included the Town of Islip Industrial Development Agency, which obligated RealtyCo to pay all taxes on the property and to do so through an escrow account administered by Capital One Bank. Thereafter, Crown paid instalment payments of the real property taxes with its rent to RealtyCo, which then made its own payment of the taxes into the bank's escrow account with its monthly mortgage payments. The taxes were remitted to the taxing authority by the bank on RealtyCo's behalf and a receipt was generated and issued to RealtyCo.

Petitioner argues that the Town of Islip or some other governmental entity should have alerted him that this payment arrangement, chosen solely by petitioner-controlled entities and his financial institution, would prevent Crown from claiming RPTCs under the law. Petitioner maintains that he relied on the government's silence to his detriment and is entitled to equitable

relief. It is apparent that petitioner merely seeks relief for his ignorance of the law, which is not a basis for the relief sought herein. Tax Law § 15(e) was in effect for years prior to execution of the mortgage and consolidation, modification and extension agreement, and petitioner was charged with knowledge of the statute. Whether or not petitioner understood the ramifications of his chosen transactional structure is irrelevant, for ignorance of the law is not a valid excuse. (***Genesee Brewing Co. v. Village of Sodus Point***, 126 Misc 2d 827 [1984] ***affd*** 115 AD2d 313 [1985]; ***accord Matter of Nathel v. Comm'r of Taxation & Finance***, 232 AD2d 826 [1996] [wherein it was held that ignorance of the law is no excuse and that a taxpayer is charged with knowledge of the law, including subsequent judicial interpretation thereof].)

Further, it was not the responsibility of any governmental entity to counsel petitioner as to his choice of business format. As a general rule, one is saddled with the consequences of a decision to structure business affairs in one manner over another. In ***Matter of 107 Delaware Associates v. State Tax Commission*** (64 NY2d 935[1985]), the Court of Appeals reversed the Appellate Division and reinstated the determination of the Tax Commission and the dissenting opinion of Justice Casey of the Appellate Division, which stated:

> "Having elected to conduct their businesses under this format, and having reaped the benefits thereof, the individual petitioners now seek to avoid any disadvantage arising out of the selected format. There is nothing irrational about the Tax Commission's determination which has the effect of binding the taxpayers to the form of business chosen by them. (***See e.g. Matter of Ormsby Haulers v. Tully***, 72 AD2d 845, 421 NYS2d 701 [1979].)" ***(Matter of 107 Delaware Associates v. State Tax Commission*** [99 AD2d 29NY2d 935 [1984].)

In this matter, petitioner chose to have Crown enter into a lease with RealtyCo prior to RealtyCo purchasing the property and entering into a mortgage agreement with Capital One. Petitioner chose to have RealtyCo pay all real estate taxes through an escrow account controlled

by the bank, which then paid the tax to the taxing authority on behalf of RealtyCo. Petitioner knowingly changed the entity he intended to have pay the tax to the taxing authority as part of his subsequent decision to have RealtyCo purchase the property and finance its purchase with Capital One. While petitioner's chosen course of action may not have been advantageous for tax purposes, he did reap the benefits of the financing arrangement and it was not irrational for the Division to hold petitioner to the form of business transactions chosen by him (***Matter of Ormsby Haulers***).

F. A tax credit is a particularized species of exemption from tax (***Matter of New York Fuel Terminal Corp.***, Tax Appeals Tribunal, August 27, 1998). Petitioner herein bore the burden of establishing entitlement to the exemption, in the face of the added hurdle that statutes creating tax exemptions are construed most strongly against the taxpayer. Further, the taxpayer must show that his interpretation of the statute is the only reasonable construction. (***Matter of CBS Corporation v. Tax Appeals Tribunal***, 56 AD3d 908 [2008].) It is determined that petitioner has not met his burden based on the rationale set forth above.

G. The petition of John and Kathleen King is denied, the Notice of Deficiency, dated January 9, 2013, is sustained and the partial refund denial for 2010 and the full denial for the year 2011, with attendant adjustments, based upon the Division's denial of the real property tax credits, are sustained.

DATED: Albany, New York
August 27, 2015

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE