STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **E. & J. GALLO WINERY** for Redetermination of Deficiencies or for Refunds of Corporation Franchise Tax Under Article 9-A of the Tax Law for the Period January 1, 2015 through December 31, 2019.	:	DETERMINATION DTA NOS. 830227 AND 850146

Petitioner, E. & J. Gallo Winery, filed petitions for redetermination of deficiencies or for refunds of corporation franchise tax under article 9-A of the Tax Law for the period January 1, 2015 through December 31, 2019.

A hearing was held before Nicholas A. Behuniak, Administrative Law Judge, in Albany, New York, on March 8, 2023 and continued to completion on March 9, 2023, with all briefs due by August 18, 2023, which date began the six-month period for the issuance of this determination. Petitioner appeared by Mayer Brown LLP (Michael Kerman, Esq., and Leah Robinson, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Jennifer Baldwin, Esq., of counsel).

ISSUES

I. Whether petitioner meets the requirements of a "qualified New York manufacturer" under Tax Law § 210 (1) (a) (vi) for the period January 1, 2016 through December 31, 2019.

II. Whether substantial understatement penalties imposed pursuant to Tax Law § 1085 (k) should be abated.

FINDINGS OF FACT

The Division of Taxation (Division) and petitioner, E. & J. Gallo Winery, submitted a joint stipulation of facts and exhibits and proposed findings of fact (stipulation). Such proposed findings of fact have been incorporated herein as deemed appropriate. The Division also submitted unnumbered proposed findings of fact in a narrative format as part of its post-hearing brief. Given the manner in which such proposed findings of fact were presented, it is not possible to make a ruling on such (***see*** State Administrative Procedure Act § 307 [1]); however, the relevant and appropriately supported portions of the Division's proposed findings of fact have been incorporated herein. In addition, petitioner submitted 61 proposed findings of fact. Petitioner's proposed findings of fact 1 through 4 are more in the nature of legal argument and are thus rejected. Proposed findings of fact 5 through 61 are supported by the record and have been substantially incorporated herein.

1. Viticulture is the cultivation of grapevines for the purpose of growing and producing grapes. It includes the growing of grapes for any commercial purpose: making wine, juice, grape concentrate, or brandy, or for consumption, such as table grapes or raisins. Viticulture does not include winemaking because it is strictly defined by the grapes.

2. Grapes grow in vineyards, which are plantings of grapevines for the commercial purpose of producing grapes. Grapevines are supported by wooden posts or stakes as part of a trellis system, and wires attached to those posts or stakes. Tiles installed underneath the vines provide drainage for excess water in the soil.

3. Grapevines have roots that take up water and nutrients from the ground and that store carbohydrates and hormones that help regulate the growth of the vine. Grapevines also have trunks that split into canes or "arms" like wooden branches. The canes contain the buds from

which the following year's shoots and grapes will originate as well as the leaves that are critical for photosynthesis.

4. Grapevines are perennial plants, meaning they undergo the same growth cycle each year without needing to be replanted from seed after each year's harvest. Grapevines continue to produce fruit each year for several decades; the typical lifespan of a commercial grapevine is 25 to 30 years.

5. The annual growth cycle for grapevines involves several steps, and it is an eighteen-month process from when fruit is initiated to the time it is harvested. The grapes that will emerge in a current year's growth cycle were formed the year prior and remain compressed inside the bud throughout dormancy until they become visible during rapid shoot growth the following season.

6. During dormancy, grapevines remain biologically active, but the activity is not visible to the naked eye. The vines are still growing and metabolizing various substances in their buds, roots, and trunks. The roots continue to take up nutrients and water, and there are many metabolic processes related to hormone physiology and carbohydrate metabolism occurring during dormancy. Dormancy lasts until "bud break" the following spring. In the Finger Lakes, dormancy generally lasts from October or November until April or May.

7. In early spring, grapevines go through a process known as "bud break," in which shoots begin to emerge from the buds.

8. The next phase is rapid shoot growth, in which green shoots emerge from the buds, leaves begin to unfold, and photosynthesis increases substantially. The shoots will later harden and become the canes that bear the grapevine's fruit.

9. After rapid shoot growth comes full canopy in mid-summer, where the leaves have grown to their full capacity and the vines have reached their full photosynthetic potential.

During this phase the grapes continue to develop and ripen, with the majority of the sugar being produced by the grapevine going into the grape clusters to increase their sugar content. The trunks and roots also begin to store carbohydrates so the vines can begin to prepare themselves for growing the following season.

10. The next phase is cane hardening, which occurs in late summer and early fall. The canes on the vines become woody and harden, which helps the grapevine to survive through the winter. The grapes are harvested soon after.

11. After harvest comes leaf fall. The leaves turn yellow as they lose their chlorophyll, and eventually fall off due to declining temperatures. During this phase, the grapevines transport additional carbohydrates from their leaves to their permanent structures, i.e., the trunks and roots, to further prepare for winter as dormancy begins again and for growth the following spring.

12. Vineyards are typically overseen by viticulturists who make technical recommendations for the vineyard and recommend specific practices, such as for proper irrigation, fertilization, and pest- and disease-management practices. A vineyard manager typically executes the plan developed by the viticulturist.

13. It is common for a vineyard owner to use a management service or land-management contract arrangement, which are common practice in both the viticulture and broader agriculture industries.

14. Petitioner is a California corporation headquartered in Modesto, California. Petitioner, together with its affiliates, is a multinational beverage manufacturing, marketing, and distributing company whose principal products include table and sparkling wines, spirits, and grape concentrate, and whose customers include beverage wholesalers, retail grocers, and distributors. Petitioner owns and operates vineyards, but 80 percent of their grapes come from third party independent growers.

15. Petitioner owned approximately 20,000 acres of vineyards in the years at issue, which produced approximately 200,000 tons of grapes each year.

16. Petitioner used approximately 170,000 tons of those grapes annually to manufacture wine, and sold the remainder to other unrelated winemakers, for example when it had an oversupply of certain varieties or when it could obtain premium prices from third party winemakers for its grapes.

17. While petitioner grew a substantial supply of the grapes it needed to produce petitioner-brand wines, 200,000 tons was still insufficient for the amount of wine petitioner manufactures. Thus, petitioner purchased approximately 800,000 tons of additional grapes annually from third-party grape-growers to manufacture petitioner-brand wines.

18. To increase its grape supply, petitioner routinely acquired established vineyards, that is, vineyards that were already producing grapes. Petitioner evaluated potential vineyard acquisitions through an established due diligence process.

19. Petitioner's senior management sought to diversify its geographic footprint because grape growing depends on climate and weather and California was regularly suffering from droughts and wildfires. New York State was a prime target for petitioner's expansion because of its already-established vineyards.

20. Beginning in August 2016, petitioner performed its standard due diligence regarding the potential acquisition of a New York vineyard along Seneca Lake, known as the Nutt Road Vineyard. The Nutt Road Vineyard is the New York vineyard at issue in this matter. As part of this process, petitioner reviewed pesticide use data, environmental factors, groundwater and hydrogeology data, water rights, soil maps, topography maps, and the grape yields and revenue from the Nutt Road Vineyard in prior years. Petitioner determined that there were no

environmental or other concerns with the Nutt Road Vineyard, and that its soils were of the highest quality for the New York State Finger Lakes area.

21. On November 11, 2016, petitioner through its subsidiary Ecco Domani USA, Inc. (Ecco Domani) entered into a purchase agreement to acquire the Nutt Road Vineyard for $1,500,000.00 from an unrelated third party, Panta Rei LLC (vineyard purchase agreement). The vineyard purchase agreement was executed by Allen Doty as Vice President of Ecco Domani and John Martini as Managing Partner of Panta Rei LLC.

22. Petitioner's purchase of the Nutt Road Vineyard closed on December 15, 2016, and the deed was recorded the following day.

23. The Nutt Road Vineyard consisted of 99.7 acres, approximately 47 of which were planted with grapevines at the time of the purchase.

24. The vineyard purchase agreement allocated $400,000.00 of the $1,500,000.00 purchase price to land. The remaining $1,100,000.00 was allocated to the vineyards (i.e., the grapevines), along with stakes and wires used to hold up the vines, and tiles used for drainage.

25. Effective December 15, 2016, petitioner (through Ecco Domani) entered into a service agreement with Martini Vineyards, Inc. (Martini Vineyards), under which Martini Vineyards agreed to farm the Nutt Road Vineyard as an independent land-management contractor to maintain the vineyard in accordance with petitioner's objectives. The service agreement was modeled off a similar agreement petitioner has used for several years at one of its California vineyards. The service agreement was not a lease. Pursuant to the service agreement, Martini Vineyards undertook full and complete management, supervision and control of the development and operation of the Nutt Road Vineyard. Specifically, under the service agreement, Martini Vineyards was required to:

“a) Devote such time, attention, and effort to the management and operation of the [Nutt Road Vineyard] as is reasonably necessary to maintain vineyards and cover crops on the [Nutt Road Vineyard] and to grow and harvest grapes, all in accordance with the best viticultural and farming practices in Yates County, New York. Farming of the vineyards shall include, but is not limited to, staking, mowing, frost protecting, plowing, dusting, cultivating, training, tying, suckering, trellising, pruning, thinning, trimming, winterizing, land preparation, ripping, discing, planting, budding, irrigating, spraying, fertilizing, harvesting, pesticide and herbicide application, grafting, hedging, cane cutting, replanting, and other practices.

b) Furnish all labor, equipment, machinery, materials, and supplies necessary to farm and manage the [Nutt Road Vineyard].

c) Devote such time and attention as necessary for the operation, repair, and maintenance of the [Nutt Road Vineyard’s] capital improvements, including, but not limited to, the roads, well pumps and motors, drainage systems and apparatus.

d) Use its best efforts to produce the highest quality grapes. Upon delivery, grapes must be sound, full mature, of characteristic color for that variety, free from mildew, insects, volatile acid smell, waterberry, and second crop, and also free of excessive sunburn, stress, raisining, and any other defect that could adversely affect the quality of table wine made from the grapes. [Martini Vineyards] agrees to use cultural practices consistent with commonly accepted methods of producing grapes for the highest quality table wines.

e) Deliver grapes harvested to point of delivery designated by the purchaser of the grapes.

f) Use its best efforts to secure at its own expense and have in its employ at all times a sufficient number of capable, trained, and supervised employees, qualified persons, duly licensed contractors, or firms to enable it to properly, adequately, and safely manage, operate, maintain, and otherwise perform any of the work or services as may be necessary or appropriate to farm the [Nutt Road Vineyard]. All matters pertaining to the employment of such employees, qualified persons, duly licensed contractors, or firms are the sole concern and responsibility of [Martini Vineyards], who is in all respects the sole employer of such persons, employees, duly licensed contractors, or firms. [Martini Vineyards] shall be solely responsible for deciding rates of pay, benefits, and other terms and conditions of employment for employees employed by [Martini Vineyards]. All persons, employees, duly licensed contractors, or firms so secured shall be employees of [Martini Vineyards] or independently duly licensed contractors to [Martini Vineyards] and not employees of [Ecco Domani]. [Martini Vineyards], who agrees to comply with all applicable laws and regulations, also shall require that each such persons, employees, duly licensed contractors, or firms complies with all applicable laws and regulations.

g) Properly maintain and service equipment as may be necessary or appropriate to safely, effectively, and efficiently carry out the purposes of [the Service] Agreement and provide primary insurance on all equipment used on the [Nutt Road Vineyard].

h) Keep and maintain, as required by [Ecco Domani], complete and accurate financial, accounting, operational, and administrative books, records, accounts, and contracts necessary and incidental to the operation and maintenance of the [Nutt Road Vineyard] (Property Records). After reasonable notice and during ordinary business hours, [Ecco Domani] and its designated representatives shall have access to the Property Records. In addition, the Property Records shall be kept and maintained separately and independently from all other farming or business records of [Martini Vineyards]. [Martini Vineyards] agrees to hold the Property Records in strict confidence and not disclose such information to any third party without the prior written consent or instructions of [Ecco Domani].

i) Pay directly to [Ecco Domani] all moneys received by [Martini Vineyards] accruing to [Ecco Domani] from the [Nutt Road Vineyard] and the operations thereon.

j) Adhere to and comply with all applicable Federal, State, county and other governmental statutes, ordinances, rules and regulations relating to all operations performed under [the Service] Agreement, including, but not limited to, those having to do with Discrimination, Harassment, Workplace Violence, Worker's Compensation, Social Security, Unemployment Insurance, hours of labor, wages, O.S.H.A. rules and regulations, regulations on equipment safety and heat illness, working conditions, work authorization status, the Migrant and Seasonal Agricultural Worker Protection Act, Family and Medical Leave Act, the handling and use of all pesticides, herbicides, and other hazardous substances, federal registration certificates, state and federal licenses, vehicle registrations and inspections stickers (if independent contractor transports workers), and like requirements affecting employers."

26. Petitioner oversaw the operations at the Nutt Road Vineyard through the land-management contractor who performed the farming so as to produce the quantity and quality of grapes petitioner wanted.

27. Petitioner owned all of the grapes grown at the Nutt Road Vineyard and sold them all to a third party.

28. Effective December 15, 2016, petitioner (through Ecco Domani) entered into a grape purchasing contract with Anthony Road Wine Company, under which Anthony Road

Wine Company agreed to purchase all grapes grown at the Nutt Road Vineyard through the completion of the 2021 harvest, based on prices published in the Cornell University Cooperative Extension's Finger Lakes Grape Pricing Survey. The grape purchasing contract was executed by Allen Doty as Vice President of Ecco Domani and John Martini as President of Anthony Road Wine Company.

29. Grape purchase agreements, in which the same vineyard owner sells grapes to the same buyer for a period of several years, are common in the viticulture industry. These arrangements are mutually beneficial to vineyard owners and winemakers because they provide vineyard owners with guaranteed prices for multiple years and provide winemakers with a known supply of grapes at predictable prices.

30. Panta Rei LLC, Martini Vineyards, and Anthony Road Wine Company were all owned by the same family, the Martinis. None of these entities were related to petitioner and petitioner had no involvement in setting up these entities, which had all been in place for years prior to petitioner's acquisition of the Nutt Road Vineyard.

31. On November 9, 2016, in contemplation of the vineyard purchase agreement, petitioner entered into a letter agreement with Martini Vineyards for petitioner to fund the purchase of six wind machines that were to be installed at the Nutt Road Vineyard shortly after petitioner's acquisition of the property. Wind machines are tall, fixed-in-place, engine-driven fans that pull warmer air down from above to raise the temperature of the air around the grapevines to protect them from cold damage. They typically raise the air temperature by 2 to 3 degrees Fahrenheit, a small but important difference that can provide substantial protection against bud loss and resulting crop damage during cold winter weather.

32. In 2018, petitioner expanded the planted portion of the Nutt Road Vineyard by nearly one-third, planting an additional 15.1 acres of grapevines, increasing the planted acreage

from 47 acres to 62.1 acres. This new acreage included several grape varieties that had not previously been planted at the Nutt Road Vineyard, including cabernet sauvignon, grüner veltliner, and pinot noir, and was added due to growing interest in Finger Lakes wines.

33. Since petitioner acquired the Nutt Road Vineyard, annual grape production has increased by 27 percent, from an average of 178.7 percent from 2006 to 2016, to 227.8 percent from 2017 to 2022. Revenue from grape sales has increased by more than 40 percent, from an average of $247,801.00 from 2006 to 2016, to $349,240.00 from 2017 to 2022.

34. In April 2019, petitioner agreed to purchase several wine brands and wineries from Constellation Brands, Inc., including the Canandaigua Winery in Canandaigua, New York.

35. In January 2021, petitioner completed its acquisition of the Canandaigua Winery. Petitioner produces several well-known brands at the Canandaigua Winery.

36. Following its expansion into New York with its acquisition of both the Nutt Road Vineyard and the Canandaigua Winery, petitioner now has approximately 260 employees in New York with payroll in excess of $18 million.

37. Petitioner is a member of a federal consolidated group under the parent company Dry Creek Corporation.

38. Petitioner's vineyards were classified as tangible property for federal income tax purposes.

39. Petitioner depreciated the property at issue (vineyards, stakes and wires, tiles, and wind machines) for federal income tax purposes and reported the depreciation on its New York returns. Each type of property had a useful life of four years or more.

40. Petitioner filed New York State general business corporation combined franchise tax returns (franchise tax returns) for tax years 2016 to 2019 on a calendar-year basis.

41. On its New York franchise tax returns, petitioner included its receipts from sales of grapes grown at the Nutt Road Vineyard in its business income.

42. On its New York franchise tax returns for tax years 2016 through 2019, petitioner computed its tax using the reduced rates provided for "qualified New York manufacturers" (QNYMs) in Tax Law § 210 (1). Using the reduced QNYM tax rates, the capital base was petitioner's highest tax base in each of the tax years at issue. Petitioner reported and paid New York franchise taxes of $181,157.00 in 2016; $159,177.00 in 2017; $112,588.00 in 2018; and $94,761.00 in 2019.

43. On its New York franchise tax returns for tax years 2016 to 2019, petitioner checked boxes under Part 1, Section A, "Qualification for preferential tax rates," indicating that it was using the lower business income base tax rate, lower fixed dollar minimum tax amounts, lower capital base tax rate, and lower capital base tax cap for QNYMs.

44. The Division audited petitioner's tax returns in two separate audits, one including the 2016 and 2017 tax years, and the other covering the 2018 and 2019 tax years.

45. The Division reviewed petitioner's depreciation schedules and determined that no adjustments to its reported depreciation were required.

46. The Division took the position that petitioner was not a QNYM in the tax years at issue, and re-computed petitioner's tax using the generally applicable tax rates rather than the reduced rates for QNYMs. As a result, the Division computed petitioner's highest tax under the business income base rather than the capital base.

47. Petitioner derived 77% to 85% of its receipts in the years at issue from manufacturing its own products. The Division agrees that petitioner derived more than 50% of its receipts from the production of goods by qualifying QNYM activities.

48. Petitioner's adjusted basis in the property at issue was more than $1,000,000.00 at the end of each taxable year at issue.

49. The Division audited petitioner's New York franchise tax returns for the tax years 2015 through 2019. During the course of the audits, the Division also requested that petitioner complete a "Qualified New York Manufacturer Questionnaire." Petitioner responded with workpapers detailing the assets Ecco Domani acquired in connection with the purchase of the Nutt Road Vineyard and disclosed that Ecco Domani acquired an additional asset in connection with the Nutt Road Vineyard in 2017, described as Wind Machine — Nutt Road Vineyards, with a placed in service date of July 1, 2017 and a cost of $162,824.99. In addition, in 2018, Ecco Domani acquired another asset, described as Stakes & Wires — Nutt Road Vineyards, with a placed in service date of July 1, 2018 and a cost of $120,572.00.

50. Based on the audits, the Division determined that petitioner did not meet all the requirements of a QNYM. Specifically, the Division determined that petitioner does not have any employees related to the Nutt Road Vineyard in New York as all activities at the Nutt Road Vineyard were outsourced to and performed by Martini Vineyards. The Division disallowed petitioner's qualification as a QNYM and re-computed petitioner's tax using the business income base. The Division also disallowed petitioner's claim for investment tax credits (ITC) in tax year 2018 on the basis that petitioner's employees did not use the assets petitioner acquired in 2018. The Division also assessed additional MTA surcharge for the tax years at issue. The additional MTA surcharge resulted from the Division's adjustments to petitioner's Metropolitan Commuter Transportation District (MCTD) allocation percentages for each of the tax years at issue, and the Division's adjustments to petitioner's tax base for tax years 2016 through 2019. Petitioner does not contest the Division's adjustments to its MCTD allocation percentages. The Division also made other adjustments to petitioner's business income and other exempt income for the tax

years at issue; these adjustments are not related to whether petitioner qualifies as a QNYM and are not at issue.

51. The Division issued a notice of deficiency, assessment number L-052268654 (the 2020 notice), to petitioner dated October 26, 2020, for tax years 2015 through 2017. The 2020 notice assessed an additional $3,687,521.00 in franchise tax and MTA surcharge, plus interest, and penalties. The Division assessed penalties for substantial understatement of tax in the amount of ten percent of the underpayment attributable to such understatement pursuant to Tax Law § 1085 (k).

52. The Division issued a notice of deficiency, assessment number L-055355881 (the 2022 notice), to petitioner dated February 9, 2022, for tax years 2018 and 2019. The 2022 notice assessed an additional $3,373,543.00 in franchise tax and MTA surcharge, plus interest, and penalties. The Division assessed penalties for substantial understatement of tax in the amount of ten percent of the underpayment attributable to such understatement pursuant to Tax Law § 1085 (k).

53. According to the Division's audit file, for tax year 2016 only, the Division determined that petitioner did not qualify as a QNYM because "[t]he taxpayer for 2016 did not produce any goods" because "no manufacturing activities took place in the last 13 days of the year," given that the harvest was completed in October and that the vines were in the dormancy stage in December. Although the Division's position was based on the grapevines being in the dormancy stage of the annual cycle, the Division's auditor did not research what happens with grapevines when they are in a dormant state.

54. According to the Division's audit file, the Division determined that petitioner was not a QNYM because under the Division's Technical Memorandum, *Real Property Tax Credit and Reduction of Tax Rates for Qualified New York Manufacturers*, TSB-M-15 (3) C, "[a]

taxpayer that contracts out its production activities to another entity cannot consider those activities in determining its eligibility as a manufacturer."

55. Viticulture is a lengthy and complex biological process that ultimately produces grapes and occurs throughout the entire year. Irrigation, insect protection, ground chemical composition analysis, fertilization, ground and air temperature analysis mitigation and control, daily maintenance and pruning of vineyard grape vines are all components of viticulture. The vines are living plants which are exposed to variables in growth and survival every day of the year. Bud break, ripening, winter/cold weather vine root growth, and other aspects of the development of harvestable grapes are all critical components in the production of grapes by viticulture.

56. At the hearing, the Division presented the testimony of Lauren Susz, Auditor 1 with the Division, who among other things, testified that petitioner had at least $1 million of qualifying property as of the close of petitioner's 2016, 2017, 2018 and 2019 taxable years.

57. At the hearing, petitioner presented the testimony of Nick Dokoozlian, Vice President of Wine Growing Research for petitioner. Prior to joining petitioner, Mr. Dokoozlian was a faculty member in the Department of Viticulture and Enology at the University of California at Davis. Mr. Dokoozlian testified that viticulture is the culture of grapevines for the purpose of growing grapes. Viticulture ultimately produces fully formed grapes that are harvested. Mr. Dokoozlian explained that grapes grow in a vineyard, which is the planting of vines for the commercial purpose of growing grapes. Mr. Dokoozlian described the parts of a grapevine and their functions. He also described the roles involved in a vineyard, including a viticulturist, vineyard manager or grower, farm labor or workers and the owner of the vineyard. Mr. Dokoozlian testified that grapes grown in vineyards are better than grapes grown in the wild because of the cultural practices applied by people and machines. Mr. Dokoozlian explained the

cycle of vine growth from bud break to rapid shoot growth to full canopy to cane hardening to leaf fall to dormancy. During bud break, there is no human intervention unless environmental factors, like a drought or frost, require it. Wind machines could be used to protect the vines from frost, and irrigation systems are used to water the vines. Farm labor or workers, or possibly the farm manager or grower, would perform these activities. During the rapid shoot growth and full canopy stages, more human intervention is necessary to thin the shoots and canopy, irrigate, and fertilize. Farm labor or workers, or possibly the farm manager or grower, would perform these activities. To thin shoots, shears can be used or even a tractor. During the cane hardening stage, minimal human intervention is required. During leaf fall, minimal human intervention is necessary, but could involve fertilization or trellis repair. Fertilization could be applied through a drip irrigation system, by tractor, or by hand. During dormancy, human intervention could be necessary for things like pruning, weed control, and trellis repair. Farm labor or workers, or possibly the farm manager or grower, would perform these activities. Mr. Dokoozlian explained that the vines and roots are alive and evolving throughout the entire year. Mr. Dokoozlian was aware of but not directly involved in Ecco Domani's acquisition of the Nutt Road Vineyard. He was not aware of the tax implications of petitioner's Nutt Road Vineyard purchase until after the acquisition was completed. Mr. Dokoozlian also testified that land-management arrangements, like the one between petitioner and Martini Vineyards, are common in the viticulture and wine production industry.

58. Petitioner also presented the testimony of Michael Colizzi, a Senior Grower Relations Representative in charge of the East Coast for petitioner and located at the Canandaigua Winery in New York. Mr. Colizzi has worked for petitioner since March of 2022. Mr. Colizzi was previously with the Cornell University Agriculture Experiment Station in Geneva, New York, and was a viticulture educator with the Cornell Cooperative Extension. Mr.

Colizzi described the dormancy period as the time from leaf fall, mid to late October or even November, to bud break, as early as March to as late as June. He testified that there was little, if any, human intervention during dormancy but, to protect against cold weather, you could "hill up" the vines, meaning wrap the base in soil. This would most likely be done in October through November. He also testified that wind machines could be used to circulate air to protect against the cold. Such activities could be performed by an owner or manager or farm laborer. Mr. Colizzi testified that, in his role as Senior Grower Relations Representative, he has nothing to do with the Nutt Road Vineyard. Mr. Colizzi also testified that land-management arrangements, like the one between petitioner and Martini Vineyards, are common in the viticulture and wine production industry.

59. Petitioner also presented the testimony of Kevin Miller, Senior Director of Corporate Tax for petitioner. Mr. Miller testified that he first became aware of New York's QNYM incentive through online information publications in mid-2016. Mr. Miller testified that petitioner considered the QNYM qualifications of the Nutt Road Vineyard acquisition but only after petitioner had completed its other due diligence to determine that the acquisition would be a good fit for the company because the vines were in good health and the vineyard would be profitable. Mr. Miller testified that tax implications were considered in the ultimate decision to purchase the Nutt Road Vineyard.

60. Petitioner also presented the testimony of Alan Reynolds, Senior Director of Central Valley Vineyard Operations with Gallo Vineyards, Inc. (Gallo Vineyards), a subsidiary of petitioner. Mr. Reynolds has worked in the agriculture industry for approximately 40 years. He has a Bachelor of Science degree from the University of California Davis and is the current chair of both the San Joaquin Water Quality Coalition and the Valley Water Collaborative. Mr. Reynolds was formally a fellow with the California Agricultural Leadership Program. Central

Valley stands for the Sacramento and San Joaquin valleys in California. Gallo Vineyards, according to Mr. Reynolds, is responsible for the oversight of the Nutt Road Vineyard but Martini Vineyards is responsible for the farming of it. Mr. Reynolds testified that he was not involved in the ultimate decision to acquire the Nutt Road Vineyard, but he did complete due diligence on the property and the area and grape growing in the Finger Lakes region prior to the acquisition. Mr. Reynolds testified that, after the acquisition of Nutt Road Vineyards, his duties with respect to the Nutt Road Vineyard included having periodic calls with the land-management contractor, Martini Vineyards, about what was taking place at the vineyard. Mr. Reynolds also testified that land-management arrangements, like the one between petitioner and Martini Vineyards, are common in the viticulture and wine production industry.

61. On or around July 12, 2021, petitioner paid the $3,687,521.00 in tax assessed for tax years 2015 through 2017, while continuing its protest of the 2020 notice.

62. On or around August 15, 2022, petitioner paid the $3,373,543.00 in tax assessed for tax years 2018 and 2019, while continuing its protest of the 2022 notice.

63. If it is finally determined that petitioner is a QNYM pursuant to Tax Law § 210 (l) (a) (vi) for tax years 2016 through 2019, then: (A) the final liability for the tax years at issue is $106,795.00 in corporation franchise tax and MTA surcharge, plus statutory interest, and substantial understatement penalties applicable to the MTA surcharge for tax years 2015 and 2017. The stipulation provides that the $106,795.00 liability relates to adjustments made by the Division that are not related to the QNYM provisions at issue in this matter and that petitioner does not contest such issues; and (B) taking into account the payments made on the 2020 and 2022 notices, the Division will refund to petitioner $7,061,064.00, less the amount computed in (A), plus statutory interest on the refund.

64. If it is finally determined that petitioner is not a QNYM for tax years 2016 through 2019, but that penalties related to the QNYM issue are to be abated, then: (A) the final liability for the tax years at issue is $7,061,064.00, plus statutory interest and substantial understatement penalties applicable to the MTA surcharge for tax years 2015 and 2017 only; and (B) taking into account the payments made on the 2020 and 2022 notices, $7,061,064.00 has already been paid; therefore, petitioner would owe additional amounts for interest, and for substantial understatement penalties applicable to the MTA surcharge for tax years 2015 and 2017.

65. If it is finally determined that petitioner is not a QNYM for tax years 2016 through 2019, and that penalties are not to be abated, then: (A) the final liability for the tax years at issue is $7,061,064.00, plus statutory interest and substantial understatement penalties; and (B) taking into account the payments made on the 2020 and 2022 notices, $7,061,064.00 has already been paid; therefore, petitioner would owe additional amounts for interest and substantial understatement penalties.

CONCLUSIONS OF LAW

A. Tax Law § 209 imposes New York corporation franchise tax on every domestic or foreign corporation, with certain exceptions, for the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in New York in a corporate or organized capacity, or of maintaining an office in New York, or of deriving receipts in New York for any part of its tax year (***see*** Tax Law § 209 [1] [a]). Every such corporation is required to pay an annual franchise tax on the basis of its business income base or any other applicable basis (***id.***). Tax Law § 210 dictates how a corporation on which the corporation franchise tax is imposed under Tax Law § 209 (1) computes its tax. Corporations, such as petitioner, which are subject to tax, in general, compute tax on the highest of three basis: (1) the business income base; (2) the capital base; or (3) the fixed dollar minimum (***see*** Tax Law

§ 210 [1]). New York provides benefits for QNYMs under each computation. Specifically, Tax Law § 210 provides a reduced tax rate for the business income base, a reduced tax rate and a reduced tax cap for the capital base, and a reduced fixed dollar minimum tax (***see*** Tax Law § 210 [1] [a] [vi], [b] and [d]).

B. The New York Legislature first enacted the Tax Law § 210 QNYM provisions in 2007, reducing the then-general rate for the entire net income base (now the business income base) from 9% to 6.5% for taxpayers principally engaged in the production of goods by several activities, including manufacturing and viticulture (L. 2007, ch. 60, pt. N).

C. The Legislature enhanced this incentive several times in subsequent years. For the 2012 tax year, it reduced the rate to 3.25 percent for "eligible" QNYMs, i.e., those who met additional requirements set by the Division (L. 2011, ch. 56, pt. C.2).[1] For the 2014 tax year, the Legislature further enhanced the QNYM incentive by reducing the business income base rate to 0 percent, ensuring that a QNYM's highest tax base would be either the capital base or the fixed dollar minimum tax, rather than the business income base (L. 2014, ch. 59, pt. R).[2]

D. The QNYM provisions, and particularly the 0 percent rate on the business income base, were designed to incentivize manufacturers to move their operations to, or expand their operations within, New York. Then-Governor Cuomo described an earlier proposed version of the 0 percent rate as "eliminat[ing] the net income tax rate on upstate manufacturers" to

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[1] The Legislature delegated the task of defining "eligible" to the Division, which issued a Technical Memorandum defining an eligible QNYM as one with a Metropolitan Commuter Transportation District allocation percentage of less than 15% and fewer than 100 full-time employees in New York (***see** Article 9-A Tax Rates for Eligible Qualified New York Manufacturers*, TSB-M-13 [1] C [2013]).

[2] This also removed the provision for "eligible" QNYMs and the delegation of authority to the Division to define eligibility.

"encourage growth of manufacturing in Upstate New York."[3] The New York State Comptroller stated that the proposed Executive Budget would provide tax relief and reduce business taxes "particularly for manufacturers," after predicting that the New York State economy would otherwise "remain weak," specifically with respect to manufacturing activities.[4] The relevant New York State Executive Budget memorandum stated:

> "Providing tax relief to manufacturers in this State is necessary to help existing New York manufacturers survive and attract new manufacturers to the State. This bill incorporates the recommendations of the New York State Tax Relief Commission by providing a real property tax credit to qualified New York manufacturers and reducing the entire net income tax rate for qualified upstate manufacturers."

After the Legislature reduced the business income base rate to 0 percent, the Division issued an informational notice in February 2015 (***see*** TSB-M-15 [3] C [February 26, 2015]) with its interpretation of the QNYM provisions. The notice stated that the Division would not issue any advisory opinions as to whether a specific taxpayer or combined group satisfies the statutory QNYM requirements (***id.***). The technical memorandum further provided:

> "A taxpayer that contracts out its production activities to another entity cannot consider those activities in determining its eligibility as a manufacturer. The contractor entity may include those activities when determining whether it meets the definition of a manufacturer" (TSB-M-15 [3] C).

The Division advances that petitioner must follow TSB-M-15 (3) C, and because it had no employees physically working at the Nutt Road Vineyard, only the land-management contractor, it is not eligible at all for the QNYM reduced tax rates, regardless of whether the land-management contractor qualifies for and utilized the QNYM reduced tax rates. However,

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[3] Press Release, New York Division of the Budget, *Governor Cuomo: This Year's Budget Is More Than Numbers; It's an Innovative Action Plan that Will Build and Shape a Brighter Future for All New Yorkers* (Jan. 21, 2014).

[4] New York State Comptroller, Report on the State Fiscal Year 2014–15 Executive Budget 4, 29 (Feb. 2014).

TSB-Ms are "informational statements of the Division of Taxation's policies" (20 NYCRR 2375.6 [a] [1]). As such, they are "advisory in nature" and "do not have legal force or effect" (20 NYCRR 2375.6 [c]; ***see Matter of Friesch-Groningsche Hypotheek Bank Realty Credit Corp.***, Tax Appeals Tribunal, December 28, 1990, ***confirmed*** 185 AD2d 466 [3d Dept 1992], ***lv denied*** 80 NY2d 761 [1992]).

E. Petitioner bears the burden of proof in any case before the Division of Tax Appeals except where that burden has been specifically allocated to the Division (***see*** Tax Law § 1089 [e]; 20 NYCRR 3000.15 [d] [5]). However, the parties dispute what petitioner must show in this matter in order for their interpretation of what qualifies as a QNYM to prevail.

The Division, citing ***Matter of TransCanada Facility, USA, Inc.*** (Tax Appeals Tribunal, May 1, 2020), contends that the special business income base tax rate applicable to QNYMs in Tax Law § 210 (1) (a) is an exemption and exclusion and, therefore, petitioner must show that its proposed interpretation of the law is the "only reasonable construction." Petitioner asserts that the statute in question is a statute which levies a tax and has reduced rates for QNYM including a clearly stated 0 percent business income base rate and is to be construed most strongly against the government and in favor of the taxpayer.

In ***TransCanada***, the Tax Appeals Tribunal (Tribunal) determined that a tax cap was not an exemption, exclusion or deduction that operated to negate a taxpayer's obligation to pay an otherwise applicable tax (***see TransCanada***). Accordingly, in ***TransCanada***, the Tribunal concluded that the tax cap provision of Tax Law former §§ 209 and 210 (1) (b) (1) were to be "construed most strongly against the government and in favor of the citizen" (***see TransCanada***, citing ***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]). The Division argues that the special business income base tax rate available to a QNYM is not a tax cap and is an exemption,

exclusion or deduction because the applicable rate is 0 percent and therefore a complete exemption from taxation. The Division's argument in this regard is rejected as the reduced rates in this case are in fact more akin to a tax limitation than an exemption, exclusion or deduction because Tax Law § 210 (1) imposes a franchise tax on a taxpayer and does not negate the taxpayer's obligation to pay the otherwise applicable franchise tax, but rather defines the applicable tax rates that may be imposed, albeit one of the rates has been reduced down to 0 percent on a QNYM's business income base. Even though the tax rate for a QNYM's income base has now been reduced to 0 percent, the evolution of this rate adjustment and the wording of the relevant statute shows that it is not an exemption but a rate reduction. The reduced tax rates at issue for QNYMs did not negate petitioner's obligation to pay tax. In fact, petitioner paid tax in each of the tax years at issue pursuant to the other applicable reduced rates of Tax Law § 210.

Accordingly, the statutory provision at issue in this case is to be construed most strongly against the government and in favor of the taxpayer (***see TransCanada***; ***Matter of Charter Communications, Inc.***, Tax Appeals Tribunal, January 25, 2024). Furthermore, ambiguity in a provision that imposes tax must be strictly construed in the taxpayer's favor (***see Matter of Grace v New York State Tax Commn.***).

F. In general, to be a QNYM under Tax Law §§ 210 (1) (a) (vi) and 210-B (1) (b) (i) (A) for the years at issue, a taxpayer or combined group, must have:

(1) been "principally engaged" (derived more than 50% of its gross receipts) in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing;

(2) owned property located in New York that had an adjusted basis of at least $1,000,000.00 at the close of each taxable year or had all of its real and personal property located in New York; and

(3) such property is principally used by the taxpayer in the production of goods by the same list of activities noted above, including manufacturing and viticulture.

There is no dispute that, for the years at issue, petitioner met the first two requirements. Accordingly, the only substantive issues in this case relate to the third requirement. With respect thereto, there are two issues. First, for all years at issue, whether petitioner's Nutt Road Vineyard's grapevines, stakes and wires, drainage tiles, and wind machines were "used in the production of goods" by petitioner when petitioner used a land-management contractor to perform the work at the Nutt Road Vineyard. Second, for 2016 only, whether petitioner's grapevines, stakes and wires, and drainage tiles were "used in the production of goods" between the date petitioner acquired the Nutt Road Vineyard, December 15, 2016, and the close of the taxable year, December 31, 2016.

G. As to the first issue, pursuant to Tax Law § 210-B (1) (b) (i) (A), the property at issue, the Nutt Road Vineyard, must have been principally used by the taxpayer in the production of goods. In this regard, petitioner had title to and owned the grapevines, stakes and wires, drainage tiles, and wind machines that constitute the "property" at issue. Petitioner (through Ecco Domani) entered into a service agreement with Martini Vineyards, under which Martini Vineyards agreed to farm the Nutt Road Vineyard as an independent land-management contractor and to maintain the vineyard in accordance with petitioner's objectives. There is no common ownership between petitioner and Martini Vineyards; they are independent, unrelated parties operating at arms-length. The service agreement was modeled off a similar agreement petitioner has used for several years at one of its California vineyards. The Nutt Road Vineyard was placed into service into what is quintessentially petitioner's main trade and business of growing and selling grapes for sparkling wines, spirits, and grape concentrate. That is, petitioner used the Nutt Road Vineyard property to produce grapes, owned all of the grapes produced, and

sold the grapes at fair-market prices. Petitioner reported the receipts from its grape sales on its New York franchise tax returns. Furthermore, according to petitioner's witnesses' uncontroverted testimony, it is a common practice for a vineyard owner to use management services or land-management contract arrangements to work on the owner's land. Such an arrangement does not detract from the fact that the landowner still owns the land and crops thereon and is using the land and crops. Nothing in Tax Law §§ 210 (a) or 210-B suggests that property is not "used by" its owner if the owner contracts with another entity to perform labor on or related to the property.

H. Tax Law § 210 (1) incorporates concepts of Tax Law § 210-B by reference. The Division's regulation and published administrative guidance regarding the meaning of "used by the taxpayer" in the related ITC Tax Law § 210-B (1) (b) (i) (A) support petitioner's eligibility as a QNYM. The Division's regulation interpretating Tax Law § 210-B (1) (b) (i) (A) limits a taxpayer's eligibility to claim an ITC for property used in the production of goods if the taxpayer leases the property to another entity (***see*** 20 NYCRR 5-2.3). There is no similar limitation for engaging a service provider/land-management contractor to work on the production of a product in order for a QNYM to utilize the reduced business income tax rate. In the case at hand, petitioner did not lease the property at issue to the land-management contractor or anyone else. In fact, the opposite happened in this case. In a leasing arrangement, a third party takes possession of the land, has rights to the land itself and typically would cultivate the agriculture on the land for its sole benefit (assuming that was the lessee's business line). In this case, petitioner never gave up possession of the vineyard but instead engaged a land-management company to perform the tasks necessary to cultivate the agriculture on the land; however, all that was done on petitioner's behalf as specified in the contract. The grapes produced at the Nutt Road Vineyard were eventually sold to an entity having a common ownership with the land-

management company's ownership, but this arrangement still does not amount to a leasing of the land. In this case, petitioner maintained control over what the land could be used for and what the land-management company was required to do on the land. In a leasing arrangement the lessee takes over the land and utilizes it as it sees fit.

I. An advisory opinion issued by the Division further supports petitioner's position. In TSB-A-98 (24) C, the Division relied on 20 NYCRR 5-2.3 when it concluded that property was "used by the taxpayer" when the relevant party, Xerox, provided property it owned to a subcontractor for use in a portion of its manufacturing process (***see*** NY St Dept of Taxation & Fin Advisory Op No. TSB-A-98 [24] C). The Division determined that the property was principally used in the production of goods by Xerox notwithstanding the use of subcontractors. The Division relied on the ITC regulation cited above, § 5-2.3, which establishes the dichotomy between leased and non-leased property and found that use by a subcontractor short of a lease does not negate the owner's right to the credit. Under the related ITC regulations, and the Division's prior interpretation of those regulations in TSB-A-98 (24) C, petitioner would be considered the "user" of the Nutt Road Vineyard property even though it used the land-management company to work the vineyard.

J. The Division advances a very narrow interpretation of the term "used" which stems from its view that petitioner must have its own employees at the Nutt Road Vineyard. In its brief the Division states:

> "Based on the audits, the Division determined that petitioner did not meet all the requirements of a QNYM. Specifically, petitioner does not have any employees related to the Nutt Road Vineyard in New York."

However, the only employee requirement in the QNYM provision is in an alternative qualification method that is not at issue here. Specifically, there are two ways to qualify under the QNYM provisions: (1) by satisfying the principally engaged in test ("Test One"); or (2) by

satisfying an alternative test ("Test Two"). Test Two is also in Tax Law § 210 (1) (a) (vi) and allows a taxpayer to qualify if it has 2,500 manufacturing employees and $100,000,000.00 of manufacturing property in New York (***see*** Tax Law § 210 [1] [a] [vi], as amended by L. 2014, ch. 59, pt. R). Test One, however, does not require employees in the state. Its requirements are clear: the taxpayer must derive 50 percent of its gross receipts from qualifying sales and must have at least $1,000,000.00 of qualifying property in New York. The Legislature choose to include an employee requirement in Test Two but did not include an employee requirement in Test One. The case at hand addresses Test One only, and there is no basis to import the requirements from one test to the other when the Legislature could have easily done such itself (***see Charter Communications, Inc***.). In the absence of any employee requirement in the QNYM provision, the Division attempts to force one into the statute, effectively rewriting the statute to say, "principally used by the taxpayer's own employees." Since Test One and Test Two of Tax Law § 210 (1) (a) (vi) deal with the same subject, such sections are in pari materia, and they should be construed together and applied consistently (***see TransCanada***, citing ***Matter of Piccolo v New York State Tax Appeals Trib.***, 108 AD3d 107, 110 [3d Dept 2013]). The Division attempts to add its own condition to the statute's existing clear language with no authority to do so.

K. "When the language of a tax statute is unambiguous, it should be construed so as to give effect to the plain meaning of the words used (citation omitted)" (***see TransCanada***, citing ***New York State Assn. of Counties v Axelrod***, 213 AD2d 18, 24 [3d Dept 1995], ***lv dismissed*** 87 NY2d 918 [1996]). Every word must, if possible, be given meaning (***see TransCanada***, citing ***Sanders v Winship***, 57 NY2d 391, 396 [1982]). The Third Department decision on the meaning of "used by," albeit outside the context of § 210-B (1) (b) (i) (A), provides useful guidance on the reading of the statute at issue. In ***Matter of Brooklyn Navy Yard Cogeneration Partners,***

LP, the Third Department addressed a former statute, Tax Law § 189 (6), which provided a credit to taxpayers who imported natural gas, used the gas to produce steam or electricity, and then sold the resulting steam or electricity to a utility, where the steam or electricity was then "used by" that utility (***see Matter of Brooklyn Navy Yard Cogeneration Partners, LP v Tax Appeals Trib. of State of NY***, 46 AD3d 1247 [3d Dept 2007], ***lv denied*** 10 NY3d 706 [2008]). The issue in that case related to this last component: whether the steam or electricity was "used by" the utility when it purchased the steam or electricity for resale to its own customers. The court agreed with the Division that mere resale was not enough for the steam or electricity to be considered "used by" the utility. In doing so, the court said: "Giving 'used' its 'usual and commonly understood meaning' in the context of the phrase 'and used by', it may be read to mean 'employed for a purpose; utilized,' 'put into service' or 'to expend or consume in use'" (***Matter of Brooklyn Navy Yard Cogeneration Partners***, ***LP v Tax Appeals Trib.***, 46 AD3d at 1248 [internal citations omitted]).

In this case, the assets at issue are "used by" petitioner under the ordinary meaning of that term. Regardless of who is subcontracted to perform day-to-day labor at the Nutt Road Vineyard, petitioner employed its grapevines for a purpose, and put the grapevines into service and petitioner qualifies as a QNYM pursuant to Tax Law § 210 (1) (a) (vi) for the years at issue.

L. Petitioner argues that "used" and "put into service" is virtually identical to the "placed in service" standard for federal depreciation purposes (***see*** Internal Revenue Code (26 USC) § 167) and such supports its position in this case. However, the Division correctly points out that property does not have to be in actual use to be depreciated (***see*** IRS Fact Sheet, FS-2006-27 [Nov. 2006]). Petitioner's argument in this regard is rejected.

M. As to the second issue noted in conclusion of law F above, whether petitioner's grapevines, stakes and wires, and drainage tiles were "used in the production of goods" between

the date petitioner acquired the Nutt Road Vineyard, December 15, 2016, and the close of the taxable year, December 31, 2016, it is determined that they were. Petitioner's purchase of the Nutt Road Vineyard closed on December 15, 2016.

Under Tax Law § 210 (1) (a) (vi), petitioner must have owned the property at issue, the Nutt Road Vineyard, at the close of the taxable year. There is no provision in the statute that requires that petitioner own the property at issue for a certain period of time in order to qualify as a QNYM. Petitioner is a calendar-year taxpayer; accordingly, the close of its 2016 taxable year was December 31, 2016. It is undisputed that petitioner owned the Nutt Road Vineyard and the related tangible property prior to, and at, that date. Given that grapevines are perennial plants, the dormancy period is a crucial part of the annual growth cycle for grapes, and the grapes that would be harvested in the summer of 2017 were already present on the vines at the time petitioner purchased the property in 2016. The Division notes that not much, if any, manual work must be performed on the grape plants during the dormancy period; however, this fact does not negate that the plants are living things and still evolving, or subject to dying, during this period, and such is an important time in the plant's overall life. In the statute at hand, the Legislature expressly included viticulture in the list of qualifying activities. The natural components of viticulture cannot be disregarded and they take place throughout the entire year. The Division offered no expertise or other evidence to contradict this fact. In its brief, the Division includes the conclusory statement that petitioner's property is not "used in production year-round via biological processes that cannot be seen by the naked eye." The Division offers no support for this statement. The record includes testimony from credible witnesses with decades of viticulture experience who explained that is in fact how grapevines work. As soon as petitioner took title to the property in 2016 it was petitioner who was responsible for protecting and nurturing the growth cycle of the grape plants throughout the entire year. Petitioner used a

land-management company to perform the work on its land, but ultimately any loss or damage to the grape plants during that period was petitioner's and likewise the undisputed growth of the grapes on the land during that period was also petitioner's. As such, petitioner is a QNYM in tax year 2016 pursuant to Tax Law § 210 (1) (a) (vi), because it owned the Nutt Road Vineyard "at the close of the taxable year" and used the vineyard "in the production of goods" by viticulture during 2016.

N. Citing ***Matter of Dunk & Bright Furniture Co., Inc.*** (Tax Appeals Tribunal, June 28, 2012), the Division attempts to recharacterize petitioner's acquisition of the Nutt Road Vineyard as "nothing more than a 'shirt change,'" referring to "a practice by which businesses reorganize to create the illusion of creating jobs, or 'phantom jobs,' and take advantage of benefits provided under the Empire Zones program." The Division's accusation is misguided. The "shirt change" analogy stems from the requirement in Tax Law § 14 that a taxpayer be a "new business" formed for a "valid business purpose" (***see*** Tax Law § 14 [j] [4] [B]). These requirements are specific to Tax Law § 14 and the Empire Zones Program and have little to do with the QNYM provisions at issue in this case. In ***Dunk & Bright Furniture***, the Tribunal described section 14 as requiring two showings from the taxpayer: (1) that tax was not the taxpayer's sole motivation for establishing the new business; and (2) that there was a valid business purpose for doing so (***see Dunk & Bright Furniture***). The QNYM business income rate provision is in fact a tax incentive, and it is not surprising that tax benefits will be something considered in a business transaction and will often be a motivating factor. The Division itself describes the tax implications as "a" motivation for petitioner in acquiring the Nutt Road Vineyard; however, petitioner's witness explained such was not the sole motivation or even the primary motivation for the Nutt Road Vineyard acquisition.

When evaluating the "valid business purpose" requirement in Tax Law § 14, the Tribunal in ***Dunk & Bright Furniture***, considered whether an internal reorganization whereby the taxpayer established a new holding company above existing operating companies "meaningfully changed" the taxpayer's economic position apart from the tax benefits realized. The Tribunal found no meaningful change: "within eight months of its formation, [the holding company] assumed all of the assets, liabilities, and the name of [the operating company], essentially returning the business to its exact state prior to the reorganization" (***see Dunk & Bright Furniture***). In this case, petitioner's economic position, in stark contrast, meaningfully changed in several ways when it purchased the Nutt Road Vineyard. Most obvious is that petitioner was not engaged in an internal reorganization but an actual purchase of real property and improvements from an unrelated third party for which it paid $1.5 million. Petitioner previously did not own the Nutt Road Vineyard but after the purchase it did own such. Petitioner benefitted from any appreciation in the value of the land and vineyard and more importantly, it made sure the grapes, vines and land were well cared for and productive by hiring a land-management company to service the land. The agricultural products on the property purchased dovetailed perfectly into the primary business line of petitioner. It earned income from selling the grapes and increased yields and revenue after it took over the property.

The facts in this case are not comparable to those in ***Dunk & Bright Furniture***, and the Division's arguments in this regard are rejected. Furthermore, it is noted that tax planning and a tax mitigation motivation does not preclude respecting a transaction if that was not the only basis for entering into such (***see Gregory v Helvering***, 293 US 465 [1935]).

O. The Division also suggests that petitioner and the land-management contractor, Martini Vineyards, or other similarly situated parties, could be both taking, or "double-dipping,"

on QNYM benefits. Specifically, the Division states that the limitations provided in TSB-M-15 (3) C:

> "ensured that two entities could not qualify as QNYMs for the same production activities in New York. If petitioner's interpretation is accepted, both petitioner and Martini Vineyards could qualify as a QNYM for the production of grapes at the Nutt Road Vineyard, a possibility that petitioner's own witness could not deny."

However, petitioner's witnesses indicated they did not know whether Martini Vineyards qualified as a QNYM or that they would be able to benefit from such a qualification on the property at issue. Martini Vineyards and petitioner are two completely separate independent entities without any common ownership or control. Moreover, nothing in the QNYM statute indicates that two taxpayers cannot independently qualify with respect to activities at a single manufacturing location (such as a vineyard, in this case) if they separately own $1 million of property used to produce goods. The property test in section 210 (1) (a) (vi) requires $1 million of tangible personal property, not real property. Thus, if Martini Vineyards had $1 million of its own property, such as tractors and other equipment, nothing would preclude it from attempting to meet the property requirement simply because that property was used on land owned by someone else. However, it would still have to meet the receipts test, which it would have to meet with its own sales, not petitioners.

P. The Division imposed penalties for substantial understatement of tax in the amount of ten percent of the underpayment attributable to such understatement pursuant to Tax Law § 1085 (k). The Division imposed those penalties because of petitioner's purportedly improper utilization of the QNYM favorable tax rates. Since the QNYM issue has been resolved in petitioner's favor, the Division is directed to cancel the related penalties assessed as such pertain to QNYM issue.

Q. The petition of E. & J. Gallo Winery is granted and the notices of deficiency bearing assessment numbers L-052268654 and L-055355881 are sustained to the extent provided in the stipulation (***see*** finding of fact 63), but otherwise canceled.

DATED: Albany, New York
February 15, 2024

/s/ Nicholas A. Behuniak
ADMINISTRATIVE LAW JUDGE