

NEW YORK STATE EMPIRE ZONES UPDATE

June 16, 2010

In a more rational world, this tax credit update would focus on the replacement for New York State's Empire Zones Program which is set to expire at the end of this month. In January, Governor Patterson proposed replacing Empire Zones with the Excelsior Jobs Program as part of his 2010-11 budget offering. However, New York is not always rational, and the state's \$9.2 billion deficit has made it difficult for administration and legislative leaders to finalize a workable fiscal plan for this budget year, which started April 1. Instead, our elected officials have been stumbling along using a series of continuing resolutions to fund government operations, and the Excelsior Program has not left the drawing board.

That does not mean there is no news with respect to the Empire Zones Program, which has been the centerpiece of tax-incentive-driven economic development in New York State for the last decade. Quite to the contrary there have been several notable developments.

New York's administrative courts have been busy addressing open Empire Zones issues. Taxpayers have, for example, debated whether special district assessments like those for sewer districts constitute "eligible real property taxes" for which the Empire Zone's real property tax credit is available. On April 8, 2010, an administrative law judge with New York's Division of Tax Appeals determined in *Matter of Milton Stevenson* that such special district assessments were "eligible real property taxes" for which a credit might be obtained. The judge reasoned that the failure of the legislature to specify that the term "eligible real property taxes" should be construed in a manner that is consistent with the definition of deductible real property taxes in the Internal Revenue Code meant that the term should be defined as an ordinary person would interpret it. Since the definition of creditable real property taxes included those that "become a lien on the real property during the taxable year," and since special district assessments and other similar surcharges become liens on the real property to which they relate if they remain unpaid, the judge determined that special district assessments were creditable real property taxes under the law.

But not so fast! Just a month later, on May 13, 2010, a different administrative law judge came to the exact opposite conclusion in *Matter of Elayne Herrick*. Since administrative law judge determinations are not precedent-setting, the issue will remain open until a higher authority probably the New York State Tax Appeals Tribunal rules. In the meantime, taxpayers should consider filing protective refunds claiming additional real property tax credits for special district assessments and other similar charges.

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In another case, *Matter of Roger Burdick*, May 13, 2010, an administrative law judge considered the application of the Empire Zones' new business limitations. Under Empire Zones, the juiciest benefits are reserved for new businesses. In 2002, the statute was changed to clarify that a business could not be a new business if it was substantially similar in *ownership* and *operation* to a pre-existing New York business. In *Burdick*, the owner of several New York auto dealerships merged the dealerships into a single corporation and claimed that the corporation was a new business eligible to claim refundable Empire Zone wage tax credits. The taxpayer conceded that the surviving entity was substantially similar in ownership to the pre-existing entities but argued that the operations of the merged entity were significantly different. In ruling in favor of the taxpayer, the administrative law judge found it persuasive that, in addition to merging the legal entities, the separate dealerships relocated to a central location and instituted centralized management, payroll, and accounting functions. The difference in the operations of the surviving entity compared to the separate operations of the predecessor entities compelled the administrative law judge to conclude that the merged entity was indeed a new business under the law and therefore entitled to enhanced Empire Zone benefits.

Matter of Graphite Metalized Holdings, Inc., April 29, 2010, presented another twist on the new business issue. Under a set of 2005 law changes, a business certified as an Empire Zone Enterprise prior to August 1, 2002, but having a limited existence prior to certification would not constitute a new business unless it was formed for a valid business purpose and not solely to gain Empire Zone benefits. In this case, a new subsidiary was formed on July 31, 2002. The timing of its formation was clearly motivated by a desire to maximize Empire Zone benefits, but corporate records indicated that a general and similar corporate restructuring that was not driven by Empire Zone benefits had been contemplated for several years prior to 2002. As a consequence, the administrative law judge determined that the subsidiary was not formed solely to gain Empire Zone benefits and thus could constitute a new business entitled to enhanced Empire Zone benefits.

Most recently, on May 20, 2010, an administrative law judge ruled in *Matter of Contract Pharmaceuticals* that the initial New York tax year of a foreign corporation did not begin until it closed its purchase of business assets in New York State. The taxpayer in question was formed March 1, 2005, in Delaware and chose an October 31 end for its tax year. Prior to its acquisition of assets and employees of a pre-existing New York business on August 26, 2005, it had negligible assets and no employees in New York State, but was engaged in substantive negotiations to purchase the business. On August 26, 2005, it did, in fact, acquire the operating assets of the pre-existing, unrelated New York business. On the next day, the taxpayer began employment of the individuals formerly employed by the business it acquired. In preparing its returns for the year, the taxpayer claimed Empire Zone credits based on the position that the employees it hired as a result of the August 26 transaction worked for the taxpayer for substantially all of its initial New York tax year, which, according to the taxpayer, began August 26, 2005, and ended October 31, 2005. Since most Empire Zone benefits are not available if a business does not have employees for at least half of the tax year, the Tax Department argued that the corporation's tax year began when it was formed on March 1 and began active negotiations in New York for the acquisition of the operating assets and the employees from the pre-existing New York business. But the administrative law judge found the taxpayer's arguments more persuasive and ruled the taxpayer was entitled to a full year's worth \$683,357 of Empire Zone credits, including \$282,000 of refundable wage tax credits for its tax year that ended October 31, 2005.

Again, all of the cases discussed above are administrative law judge determinations, which are not precedent setting. However, it is interesting to see that many of the anti-taxpayer positions asserted by the New York State Department of Taxation and Finance are not being sustained after full evidentiary hearings.