

## NEW YORK STATE EMPIRE ZONE TAX BENEFITS

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In 1986 the New York State Economic Development Zone (now known as Empire Zone) statute was created to assist businesses in locating to distressed economic areas. The following outlines the procedures for applying for Empire Zone designation and the tax incentives available if designated.

Prior to April 2005, Empire Zone acreage was often provided to businesses located both in and out of economically distressed inner-city or urban areas. Statutory changes eliminated this "spot zoning" approach and provided that as of January 1, 2006, every Investment Zone<sup>2</sup> be re-designated to be contained entirely within three or four separate and distinct contiguous areas, and every Development Zone<sup>3</sup> be re-designated to be contained entirely within six or seven separate and distinct contiguous areas. This was a one-time reconfiguration. Any certified business entity located outside of the Empire Zone's distinct and separate contiguous areas will be grandfathered in under the tax laws that were in effect when the entity was first certified until expiration of the Tax Benefit Period.

Any new project that is not located within these newly-designated areas, but is seeking Empire Zone acreage designation outside of these areas, must qualify as a "regionally significant project" in order to be eligible for Empire Zone certification. A regionally significant project's zone acreage footprint does not count against an Empire Zone's acreage total. There are four categories of regionally significant projects including: (i) manufacturing creating 50 or more jobs; (ii) agri-business, high tech, or biotech business making a capital investment of \$10 million and creating 20 or more jobs; (iii) financial or insurance or distribution center creating 300 or more jobs; and (iv) other (to be defined in future Rules

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<sup>1</sup> The Empire Zone program is very complex. Further, a project that is eligible for Empire Zone benefits may also be eligible for other state, local or federal tax benefits. Attorneys in the Harris Beach Public Finance/Economic Development Practice group have significant experience with the Empire Zone program on projects of all sizes. Please feel free to contact Robert Murray ([bmurray@harrisbeach.com](mailto:bmurray@harrisbeach.com)), Justin Miller ([jmiller@harrisbeach.com](mailto:jmiller@harrisbeach.com)), Shawn Griffin ([sgriffin@harrisbeach.com](mailto:sgriffin@harrisbeach.com)) or Robert Ryan ([rryan@harrisbeach.com](mailto:rryan@harrisbeach.com)) at their respective e-mail addresses or through the toll-free number as indicated above.

<sup>2</sup> Investment Zones are Empire Zones based on census tract data.

<sup>3</sup> Development Zones are Empire Zones established as county-wide zones.

and Regulations). A fifth regionally significant project category has been established for a Clean Energy Research and Development Enterprise as defined in §957 of the New York General Municipal Law.<sup>4</sup>

An exception to qualifying as a regionally significant project outside of an existing Empire Zone in order to obtain Empire Zone benefits exists for an entity that qualifies as a Clean Energy Enterprise (“CEE”) under New York General Municipal Law §959-b. Under this section, a CEE means “any business primarily engaged in research, development or manufacturing of renewable energy or energy efficiency technologies or products; provided, however, that an initial clean coal electric generating facility capable of capturing carbon dioxide for sequestration or capable of being retrofitted to capture carbon dioxide for sequestration shall constitute an eligible business for purposes of this section”. In effect, a CEE will be able to access Empire Zone benefits anywhere in New York State without the need to be located within an existing Empire Zone. Specifically, New York General Municipal Law §959-b(b) requires the commissioner of the New York State Department of Economic Development (“DED”) to promulgate regulations, after consultation with the Executive Director of NYSERDA, governing (i) criteria of eligibility for designation of a CEE, (ii) the application process; and (iii) the certification by the commissioner of DED as to the eligibility of the business for benefits referred to in New York General Municipal Law §966 (i.e. the Empire Zone benefits). In addition, the commissioner of DED will serve as the sole certification officer and such certified businesses will be deemed to be eligible for Empire Zone benefits as if they were located in an “Investment Zone”.

The tax benefits that were added to the Program in 2000, commonly called the “QEZE Benefits,”<sup>5</sup> tend to be the most powerful in providing incentives to businesses. These benefits can: (i) effectively eliminate a business's real property taxes (the QEZE Credit for Real Property Tax); (ii) eliminate a business's State income or franchise tax (the QEZE Tax Reduction Credit); and (iii) eliminate its State sales tax (the QEZE Sales Tax Exemption). The QEZE benefits compliment the pre-2000 Program tax benefits, including the Empire Zone Investment Tax Credit, the Empire Zone Employment Incentive Credit, the Empire Zone Wage Tax Credit, and the Empire Zone Capital Tax Credit (collectively, these benefits are referred to herein as the “Other Benefits” under the Program). Below please find a brief description of the QEZE benefits (drafted to reflect post April 1, 2005 statutory changes) as well as the “other” Empire Zone benefits.

## **A. THE QEZE BENEFITS**

### **1. The QEZE Credit for Real Property Taxes (the “CRPT”)**

The QEZE CRPT is a refundable New York income/franchise tax credit that can be equal to as much as 100% of a QEZE’s eligible real property taxes. Because it is a refundable credit, QEZEs that

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<sup>4</sup> New York General Municipal Law §957(r) defines a “Clean Energy Research and Development Enterprise” as “any electric generating facility that used pulverized coal technology, circulating fluidized bed technology or integrated gasification combined cycle technology and that is capable of capturing carbon dioxide for sequestration or capable of being retrofitted to capture carbon dioxide for sequestration”. New York General Municipal Law §960(a-1) provides that the Empire Zone Designation Board may consider designating Empire Zone acreage for certain categories of regionally significant projects as set forth in §957 of the General Municipal Law, including designating such acreage for a clean energy research and development enterprise.

<sup>5</sup> QEZE means “Qualified Empire Zone Enterprise”

generate no taxable income in New York may still take advantage of the CRPT by claiming any unused portion thereof as a tax refund.

(a) Pre-April 1, 2005 QEZE Credit for Real Property Taxes

Prior to April 1, 2005, the CRPT was based on the real property taxes assessed on real property owned by a QEZE and located within an Empire Zone (referred to as "Eligible Real Property Taxes"). Eligible Real Property Taxes also included Payment In Lieu of Tax ("PILOT") payments under certain circumstances. Prior to April 1, 2005, the Tax Benefit Period of the CRPT consisted of fourteen consecutive tax years, beginning with the first tax year during which the taxpayer is certified. The CRPT was available at up to 100% of eligible real property taxes for the first ten years of the Tax Benefit Period, then phased out in 20% increments over years eleven through fourteen (i.e., the CRPT is limited to 80% of Eligible Real Property Taxes in year eleven, 60% in year twelve, etc.). To claim the CRPT, the taxpayer must meet the QEZE Employment Test on an annual basis. The QEZE Employment Test requires an eligible business's employment level, both (i) in an Empire Zone and (ii) in the State but outside any Empire Zone, to be at least equal to its employment level during its "Base Period" within those same two areas. The Base Period was defined as the five tax years preceding the taxpayer's "Test Year", which was defined as the tax year immediately prior to the year the taxpayer first became eligible for Empire Zone tax benefits.

The amount of the pre-April 1, 2005 CRPT was limited based on job creation or tax basis in the subject real property. Specifically, the CRPT limit was the greater of either the Employment Increase Limitation or the Capital Investment Limitation as described below:

(1) Employment Increase Limitation is the product of \$10,000 multiplied by the excess of the QEZE's Employment Number in the Empire Zones in which it is certified over the QEZE's Test Year Employment Number in such zones; or

(2) Capital Investment Limitation which is the product of:

(i) 10% of the greater of either: (a) the cost or other basis for federal income tax purposes (determined on the later of January 1, 2001 or the effective date of the QEZE's certification) of real property, including buildings, owned by the QEZE and located in an Empire Zone in which the QEZE is certified; or (b) the cost or other basis for federal income tax purposes of such real property described in (a), above, on the last day of the taxable year; and

(ii) the greater of either: (a) the percentage of the realty which is physically occupied and used by the QEZE or by a related person of the QEZE; or (b) the percentage of such cost or other basis which is attributable to the construction, expansion or rehabilitation of the property, rather than the acquisition of such real property, by the QEZE. If the percentage of said construction, expansion, or rehabilitation equals or exceeds fifty percent, then the percentage shall be deemed to be 100%.

(b) First Certification after April 1, 2005: New Definitions

First and foremost, for taxpayers first certified on or after April 1, 2005, a QEZE is defined as a business enterprise which annually meets the Employment Test during the Tax Benefit Period. The Tax

Benefit Period consists of the first ten (10) taxable years starting with the first taxable year in which the business is certified.

For the CRPT and Tax Reduction Credit ("TRC"), the Base Period for those entities first certified on or after April 1, 2005 is now limited to the four (4) taxable years (or such smaller set of years) prior to the first taxable year in which the business is certified. For the QEZE Sales Tax Exemption ("STE"), the Base Period consists of the three years prior to the Test Year. (Note that for the CRPT and the TRC, the Test Year is now included in the Base Period).

The Employment Test will now be met for a taxable year if (i) the business enterprise's employment number in New York State for the taxable year *exceeds* its employment number in the State for the Base Period, and (ii) the business enterprise's employment number in all Empire Zones for the taxable year *exceeds* its employment number in all Empire Zones for the Base Period. Note that a taxpayer must now exceed, rather than equal or exceed, its Base Period employment number. Also note that this new Employment Test eliminates the prior Employment Test that considered both in-Zone and out-of-Zone employment numbers separately.

The term Test Date, with respect to taxpayers first certified on or after April 1, 2005, is the date prior to July 1, 2011 on which such taxpayer was first certified. The term Test Year means the last taxable year of the business enterprise ending before the test date.

Although the definition of the term Employment Number remains the same, individuals employed in New York State by a related person within the immediately preceding 60 months cannot be included. Effective as of January 1, 2002, a related person also includes an entity which would have qualified as a related person of the QEZE if it had not been dissolved, liquidated, or merged with another entity or otherwise ceased to exist or operate.

A business enterprise seeking its first certification on or after April 1, 2005, with a Base Period of zero years, *or*, with zero employment in the Base Period, is now subject to additional employment test requirements, such that it will only meet the Employment Test if it qualifies as a New Business.

A New Business is any business entity which is not substantially similar in operation and in ownership to a business entity taxable, or previously taxable, under Article 9, 9-A, 23, 32, or 33, or has or had income or losses which are or were includable under Article 22 of the New York Tax Law. For tax years beginning on or after January 1, 2005, a business which is identical in ownership and operation to an existing taxpayer will qualify as a new business if the two businesses are operating in different counties in the state, however, the new business will use the remaining Tax Benefit Period of the existing QEZE to which it is identical.<sup>6</sup>

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<sup>6</sup> April 2005 statutory changes with respect to the Employment Test also affect taxpayers that were first certified prior to August 1, 2002. For these entities, if the Base Period is zero years or the Base Period employment is zero and the enterprise is similar in ownership and operation to an existing or previously existing taxpayer, then the enterprise will be able to continue to access QEZE benefits for taxable years beginning on or after January 1, 2005 only if the enterprise was formed for a valid business purpose and not solely to gain Empire Zone benefits. A Valid Business Purpose means one or more business purposes, other than the avoidance or reduction of taxation, which alone or in combination constitutes the primary motivation for some business activity or transaction, which activity or transaction changes in a meaningful way, apart from tax effects, the economic position of the taxpayer. The economic position of the taxpayer includes an increase in the market share of the taxpayer or the entry by the taxpayer into new business markets.

Finally, significant changes were made to the CRPT for entities first certified on or after April 1, 2005, specifically with respect to the term Eligible Real Property Taxes. Specifically, a QEZE landlord, a non-QEZE tenant, and a QEZE tenant can now all make Eligible Real Property Tax payments.

In the first instance, with respect to a QEZE landlord, Eligible Real Property Taxes now mean taxes imposed on realty which is owned by the QEZE and located in an Empire Zone with respect to which the QEZE is certified, provided such taxes are paid by the QEZE which is the owner of the realty.

In the second instance, with respect to a non-QEZE tenant, the term Eligible Real Property Taxes includes those that are paid by a non-QEZE tenant which (i) does not meet the eligibility requirements to qualify as a QEZE, or (ii) cannot treat such payment as Eligible Real Property Taxes and (iii) such taxes become a lien on the real property during the taxable year in which the owner of the real property is both a QEZE and certified under Article 18-B of the New York General Municipal Law.

In the last instance, with respect to a QEZE tenant, the term Eligible Real Property Taxes also includes taxes paid by a QEZE tenant which is a lessee of real property if (1) the taxes must be paid by the lessee pursuant to explicit requirement in a written lease executed or amended after June 1, 2005, (2) such taxes become a lien on the realty during the tax year in which the lessee is a QEZE, and (3) the lessee has made direct payment to the taxing jurisdiction and has received a receipt for the same such payment.

(c) Newly Designated Empire Zones or Boundary Changes

With respect to newly designated Empire Zone acreage, or if the boundaries of an existing Empire Zone have been revised, the Employment Number in the Base Period and Test Year are determined as if the new zone or the boundaries of the revised zone existed during the Base Period and Test Year and the taxpayer had been located in the new or revised zone. If a new Empire Zone or a revised Empire Zone boundary now encompasses a business entity, that business entity will be treated as if the new zone or revised zone existed during both the Base Period and Test Year and as if the business enterprise had been located in the new or revised zone.

(d) QEZE Credit For Real Property Taxes: Post April 1, 2005

The post April 1, 2005 CRPT for taxpayers first certified on or after April 1, 2005 largely depends on whether the taxpayer is located in an Investment Zone or a Development Zone. To claim the CRPT, a taxpayer must first pass the Employment Test as described in (b) above. The CRPT is no longer based on the amount of the Eligible Real Property Tax expense; it is instead capped at an amount equal to the taxes imposed on real property owned by the QEZE, or an amount equal to the payment made under a PILOT agreement.

Specifically, the amount of the CRPT for taxpayers first certified on or after April 1, 2005, is the greater of either the Credit Amount or the Capital Investment Amount, further dependent upon whether the QEZE is located in an Investment Zone or a Development Zone. In either case, the amount of the CRPT cannot exceed the Eligible Real Property Tax expense. The Investment Zone and Manufacturing Entity CRPT formula and the Development Zone (excluding Manufacturing Entities) CRPT formulas are provided below as follows:

(1) Investment Zone and Manufacturing Entity CRPT

The Credit Amount for a QEZE, which is a manufacturer, or is certified only in an area or areas designated as an *Investment Zone*, is the product of (A) 25%; and (B) the total wages, health and retirement benefits of Net New Employees for the taxable year (where the compensation package for each Net New Employee cannot exceed \$40,000.) The term Net New Employees means the excess of the QEZE's Employment Number in the Empire Zones with respect to which the QEZE is certified for the taxable year, over the QEZE's Employment Number in such zones for the Base Period.

The Capital Investment Amount for a QEZE certified only in an area or areas designated as an *Investment Zone, or which is a Manufacturer*, is the product of (i) and (ii), below:

(i) 10% of the greater of either:

(a) the cost or other basis (*including acquisition basis*) for federal income tax purposes determined on the effective date of the QEZE's certification of real property and buildings owned by the QEZE and located in Empire Zones in which the QEZE is certified; or

(b) the cost or other basis for federal income tax purposes of such real property on the last day of the taxable year; and

(ii) The greater of either:

(a) the percentage of the real property referenced above physically occupied and used by the QEZE or by a related person of the QEZE, or

(b) the percentage of the cost or other basis attributable to the construction, expansion or rehabilitation of the same real property, as opposed to its acquisition, by the QEZE. If such percentage is 50% or more, then the percentage shall be deemed 100%.

(e) Development Zone CRPT

Again, the CRPT is the greater of either the Credit Amount or the Capital Investment Amount.

(1) The Credit Amount for a QEZE certified in an area designated as a Development Zone with the exception of Manufacturers, or a QEZE which is certified in both a Development Zone and an Investment Zone with the exception of a Manufacturer, is the product of (i), (ii) and (iii), below:

(i) 25%; and

(ii) the total wages, health and retirement benefits of Net New Employees for the taxable year (where the compensation package for each Net New Employee cannot exceed \$40,000); and

(iii) the Development Zone Employment Increase Factor of 0.25 for one to ten Net New Employees; of 0.50 for 11 to 49 Net New Employees, of 0.75 for 50 to 75 Net New

Employees; of the quotient of Net New Employees divided by 100; and up to 1.0 for 76 or more Net New Employees.

(2) The Capital Investment Amount for a QEZE certified in an area designated as a Development Zone with the exception of Manufacturers, or a QEZE which is certified in both a Development Zone and an Investment Zone with the exception of Manufacturers, is the product of (i), (ii), and (iii), below:

- (i) 10%; and
- (ii) the amount of such cost or other basis attributable to the construction, expansion or rehabilitation (*not including acquisition basis*) of the real property and building owned by the QEZE located in an Empire Zone in which the QEZE is certified; and
- (iii) the percentage of the real property physically occupied and used by the QEZE or by a related person of the QEZE. If 50% or more of the cost or other basis is attributable to the construction, expansion or rehabilitation of the real property, as opposed to the acquisition, then the occupancy percentage is deemed to be 100%.

## **2. The QEZE Tax Reduction Credit (the "TRC")**

The TRC is a New York income/franchise tax credit that can shield up to 100% of a QEZE's taxable income generated from its operations within an Empire Zone from taxation by the State. The Tax Benefit Period for taxpayers first certified on or after April 1, 2005, is the same as that of a CRPT: ten years.

The amount of the TRC is a function of employment increases. If a QEZE experiences a 100% increase in employment, or a net increase of 100 new full time jobs in the tax year over its test year employment number in an Empire Zone, it may be entitled to the TRC in an amount up to 100% of the New York income/franchise tax attributable to its operations within an Empire Zone. If a QEZE has business operations both within and outside of an Empire Zone, its TRC will be pro-rated to reflect the ratio of its operations within an Empire Zone vis-à-vis its Statewide operations. This ratio is a function of the QEZE's payroll and assets.

The TRC is only available to taxpayers who satisfy the Employment Test on an annual basis, as described in Section 1(b), above. Other than the new Tax Benefit Period and the new Employment Test, the TRC formula remains unchanged for taxpayers first certified on or after April 1, 2005, such that the TRC is equal to the product of the (i) Tax Benefit Period Factor; (ii) the Employment Increase Factor; (iii) the Zone Allocation Factor; and (iv) the Tax Factor. Note that the Tax Factor for a sole proprietor is the portion of the taxpayer's income tax liability in the taxable year attributable to the income of the QEZE partnership. The Tax Factor for a shareholder of a New York S-Corporation which is a QEZE is that portion of the taxpayer's income tax liability in the taxable year attributable to the income of the QEZE S-corporation. The Tax Factor for corporate taxpayers is the larger of the tax on the entire net income base or the minimum table income base for Article 9-A taxpayers, the larger of the tax on entire net income or the alternative entire net income for Article 32 taxpayers life insurance filers, and the larger of the tax on entire net income or entire net income plus compensation as calculated on a pro-forma return calculating a

tax on income for the year for Article 33 non-life insurance filers. In addition, note that any amount of the TRC not deductible in the current taxable year may not be carried over or refunded.

**3. The QEZE Sales Tax Exemption (the "STE")**

The STE applies to most purchases subject to sales tax, including vehicles and utilities. Like the CRPT and the TRC, an eligible business needs to satisfy the Employment Test, as described in Section 1(b) above. Note that the STE can be used for both construction and operations.

For purposes of the STE, the term Base Period for a business enterprise first certified on or after April 1, 2005 means the three taxable years immediately preceding said business enterprise's Test Year.

**B. OTHER BENEFITS**

**1. Empire Zone Investment Tax Credit (the "ITC")**

The ITC rewards capital investments made by an eligible business in tangible personal property and other tangible property in an Empire Zone with a State income or franchise tax credit of either 8% or 10% of the amount of the investment, depending on what Article of the New York Tax Law under which a taxpayer is subject. The ITC is separate and distinct from the non-Empire Zone investment tax credit that is available under New York Tax Law, which is more limited in its availability and is one-half the amount of the Empire Zone ITC.

The ITC is available for investments in facilities located in an Empire Zone used for: (i) manufacturing; (ii) industrial waste treatment or air pollution control; (iii) research and development; (iv) broker/dealer operations; (v) investment advisory services; and (vi) securities exchange operations. A taxpayer that is a "new business" may elect to treat half of its unused ITC as an overpayment of taxes and receive a refund therefore.

**2. The Employment Incentive Credit (the "EIC")**

The EIC is available to an eligible business that is entitled to the ITC and that minimally increases its historic employment level. Specifically, a taxpayer who, in years 2, 3, or 4 (where said taxpayer was entitled to the ITC in year 1) has an in-Zone employment level of at least 101% of its average employment level for year 0 (or year 1 if it did not exist in year 0), may claim the EIC for each such year in an amount equal to 30% of the ITC.

**3. The Wage Tax Credit (the "WTC")**

The WTC rewards an eligible business's creation of jobs in an Empire Zone with a State income tax credit of either \$1,500 (non-targeted employee) or \$3,000 (targeted employee including certain economically-disadvantaged persons as specifically defined in the New York Tax Law and honorably discharged members of the armed forces) per job created. Note that for businesses located in Investment Zones only, the WTC increases by \$500 for employees with wages in excess of \$40,000 (\$2000 for non-targeted employees and \$3,500 for targeted employees). The WTC is available for a discrete five-year period, which is essentially the first five years a taxpayer operates in an Empire Zone.

If a taxpayer creates one full-time non-officer job in an Empire Zone and retains that position for this five-year period, that taxpayer will be entitled to the WTC in the aggregate amount of \$7,500, or \$15,000 if the employee retained is an economically-disadvantaged person. Like the CRPT and the TRC, in order to claim the WTC for any given tax year, a taxpayer must first satisfy an Employment Test, which requires that the taxpayer maintain its historic employment level both in an Empire Zone and in the State but outside any Empire Zone. Like the ITC, the WTC may be partially refundable for a "new business".

#### **4. The Empire Zone Capital Tax Credit (the "CTC")**

The CTC is designed to reward: (i) qualified investments or contributions to a Zone Capital Corporation; (ii) qualified investments in zone-certified businesses; and (iii) contributions of money to Community Development Projects. The CTC is equal to 25% of the amount of the qualified investment or contribution. The CTC has limitations both at the taxpayer level and the Empire Zone level, and requires Empire State Development's pre-approval to claim the credit.

The CTC can be used by a zone-certified business seeking to attract outside investment by allowing such a business to offer a potential investor a State income tax credit equal to 25% of its investment in the zone-certified business. The CTC can also be used by a tax-exempt entity that has been designated as a Community Development Project to encourage contributions to it by offering a potential contributor a State income tax credit equal to 25% of its contribution in addition to the tax-deductibility of the contribution. The CTC can also be used to encourage qualified investments in, or contributions to, Zone Capital Corporations, which are economic development entities established to assist Zone-businesses with growing their operations.

As of April 1, 2005, new Zone Capital Credit Corporations are no longer permitted. Existing Zone Capital Credit Corporations are not affected; however, contributions from January 1, 2005 and onward are no longer eligible for the 25% tax credit.

#### **5. Utility Discounts**

In addition to the State tax incentives available under the Program, some utilities provide discounts to Zone-certified businesses. These discounts are generally only available for "new load" or increases in utility usage. An Empire Zone certified business that is interested in these discounts should make inquiry with its utility service provider.