

**Qualified Empire Zone Enterprise (QEZE) Exemptions  
from Sales and Compensating Use Tax**

Governor George E. Pataki recently signed into law Chapters 63 and 161 of the Laws of 2005. Included in these amendments are several changes to the Empire Zones program under the General Municipal Law (GML) and the Tax Law that affect the eligibility of businesses to pass the employment test and qualify for the tax benefits and exemptions available to a Qualified Empire Zone Enterprise (QEZE) under the Tax Law.

Article 18-B of the General Municipal Law, under which Empire Zones (EZs) are designated, has been amended to extend the designation of EZs through June 30, 2011. In addition, the GML was amended to authorize 12 new zones. EZs will now be designated as either an investment zone (IZ) or a development zone (DZ). This classification as either an investment zone or a development zone will not affect the sales tax exemptions available to a QEZE under section 1115(z) of the Tax Law.

The purpose of this memorandum is to summarize the changes made by the legislation to the employment test. For further information regarding the sales tax QEZE exemptions, including definitions of the terms *test year*, *taxable year*, *employment number* and *new business*, see TSB-M-02(5)S, *Qualified Empire Zone Enterprise (QEZE) Exemptions*.

**Background information on the QEZE sales and use tax exemptions**

The Tax Law provides that certain purchases and uses of tangible personal property and services by a QEZE are exempt from the New York State sales and use taxes and from the additional sales and use tax imposed by section 1109 of the Tax Law within the Metropolitan Commuter Transportation District. The MCTD consists of New York City and the counties of Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk and Westchester. The exemptions do not apply to any locally imposed sales and use taxes unless the county, city, or school district imposing those taxes elects to provide the exemptions.

To qualify for QEZE sales tax exemptions, a business enterprise must be certified under the GML and must also be certified by the Commissioner of Taxation and Finance. To be certified by the Commissioner, the business enterprise must meet the employment test, which compares its employment number for the most recently completed taxable year to its employment number for the base period. Once certified by the Commissioner of Taxation and Finance, the sales tax exemptions under section 1115(z) of the Tax Law are available for 120 consecutive months, **provided the QEZE annually meets the employment test**. The key elements of the employment test involve the employment number of a QEZE during a taxable year as measured against the employment number during the QEZE base period.

Chapters 63 and 161 made changes that affect the employment test. The specific changes depend on when the QEZE was certified under the GML. Certain changes only affect QEZEs certified under the GML on or after April 1, 2005. This TSB-M will (1) summarize the employment test for QEZEs certified under the GML prior to April 1, 2005 (noting an amendment to apply the new business test to business enterprises certified prior to August 1, 2002); (2) address the changes to the employment test for QEZEs certified on or after April 1, 2005; and (3) note other changes to the employment test that do not depend on whether the QEZE was certified before or after April 1, 2005.

### **QEZEs certified under the GML prior to April 1, 2005**

For a business enterprise certified under the GML prior to April 1, 2005, the employment test continues to be met if:

- the business enterprise's *employment number* in all EZs for the *taxable year* **equals or exceeds** its *employment number* in all EZs for the *base period*; and
- the business enterprise's *employment number* in New York State outside of EZs for the *taxable year* **equals or exceeds** its *employment number* in New York State outside of EZs for the *base period*.

*Example: XYZ Corp. was certified under the GML on October 2, 2004, and is applying for certification by the Commissioner of Taxation and Finance. Its employment number in EZs for its taxable year being measured was 200 employees and its employment number in EZs for the base period was 200 employees. In addition, its employment number in the state outside of EZs for its taxable year being measured was 65 and its employment number within the state outside of EZs for the base period was 60 employees. XYZ Corp will meet the employment test because its employment number for its taxable year within EZs equaled or exceeded its employment number within EZs for the base period, and the employment number for the taxable year within the state outside EZs equaled or exceeded its employment number within the state outside EZs for the base period.*

For a business enterprise certified under the GML prior to April 1, 2005, the base period continues to be the five taxable years immediately preceding the test year (*i.e.*, the taxable year ending before the test date, which is the later of the date the business enterprise was first certified under the GML, or July 1, 2000).

Also, as under prior law, a business enterprise certified under the GML between August 1, 2002, and March 31, 2005, that has a base period of zero years and an employment number in EZs of greater than zero with respect to a taxable year will meet the employment test only if the business enterprise qualifies as a new business.

Under the amendments, the new business test will also apply to a business enterprise certified under the GML prior to August 1, 2002, that has a base period of zero years or zero employment in the base period. If such a business enterprise is substantially similar in ownership and operation to an existing or previously existing taxpayer, it may qualify as a new business only if it was formed for a valid business purpose and not solely to gain EZ benefits. The term *valid business purpose* means one or more business purposes, other than the avoidance or reduction of taxation, which alone or in the combination constitute 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.

### **QEZEs certified under the GML on or after April 1, 2005**

#### **Employment test**

The amendments made changes to the employment test that apply only to business enterprises certified under the GML on or after April 1, 2005. Under these amendments, business enterprises will include their employees within EZs in their statewide employment numbers, and the number of employees in the taxable year being measured must exceed (not merely be equal to) the number in the base period for both EZs and the state in order to pass the employment test. The new business test will apply to business enterprises with a base period employment of zero in addition to those with a base period of zero years. The base period has also been shortened from five years to three years. These changes do not apply to employment tests measured by taxable years

beginning prior to January 1, 2005. For an employment test measured by a taxable year beginning prior to January 1, 2005, the business enterprise must use the same employment test applicable to business enterprises certified prior to April 1, 2005.

For employment tests using a taxable year beginning on or after January 1, 2005, a business enterprise that was certified under the GML on or after April 1, 2005, will meet the employment test if:

- its *employment number* in all EZs for the *taxable year* **exceeds** its *employment number* in all EZs for the *base period*; and
- its *employment number* in New York State for the *taxable year* **exceeds** its *employment number* in New York State for the *base period* (see below).

*Example: ABC Corp., which files its corporate franchise tax returns using a calendar year, is certified under the GML on June 15, 2006, and applies for certification by the Commissioner of Taxation and Finance in July, 2006. Its employment number for the most recently completed taxable year (2005) within EZs is 85 employees, and the employment number within EZs for the base period is 76 employees. In addition, its employment number for taxable year 2005 in New York State, including EZs, is 90 employees and its employment number in New York State, including EZs, for the base period is 81 employees. ABC Corp. meets the employment test because its employment number within EZs for taxable year 2005 exceeds its employment number within EZs for the base period **and** the employment number for taxable year 2005 within the state exceeds its employment number within the state for the base period.*

*Example: DEF, LLC, a calendar year taxpayer, is first certified under the GML on May 7, 2006, and applies for certification by the Commissioner of Taxation and Finance in July, 2006. Its employment number for its most recently completed taxable year (2005) within the zone is 17 employees, and the employment number for the base period is 17 employees. In addition, the employment number within New York State for taxable year 2005 is also 17 employees, and its employment number for the base period in New York State is 17 employees. DEF, LLC does **not** meet the employment test because its employment number for taxable year 2005 does not exceed the employment number for the base period for either the zone employment or the state employment.*

*DEF, LLC is not eligible to be certified by the Commissioner of Taxation and Finance to receive QEZE sales tax exemptions for taxable year 2006 but may reapply in 2007. If at that time DEF, LLC meets the employment test, it may be certified by the Commissioner of Taxation and Finance to receive QEZE sales tax exemptions for taxable year 2007.*

If the business enterprise has a base period of zero years or its base period employment is zero and it has an employment number in the EZ greater than zero in the taxable year, the employment test will be met only if the business enterprise qualifies as a new business.

For purposes of the sales and use tax benefit period, if the business enterprise is certified under the GML during its first taxable year and otherwise qualifies as a new business, the employment test will be met for that taxable year in any month in which its employment number exceeds zero.

### **Base period**

For purposes of the sales and use tax benefit period, the term *base period* for a business enterprise certified under the GML on or after April 1, 2005, has been changed to mean the three taxable years immediately preceding the business enterprise's test year, which will be applicable when calculating the employment test

using taxable years beginning on or after January 1, 2005. When calculating the employment test using a taxable year beginning prior to January 1, 2005, the QEZE would follow the previous rule, calculating the base period using the 5 taxable years immediately preceding the test year.

*Example: ABC Corp. becomes certified under the GML on June 15, 2005. ABC Corp. then files the DTF-80, Application for Registration as a Qualified Empire Zone Enterprise (QEZE), with the New York State Department of Taxation and Finance. When completing the employment test portion of the application, the date the business enterprise was first certified under the General Municipal Law is the test date, which in this example would be June 15, 2005.*

*The test year is the last taxable year for the business enterprise ending before the test date. If ABC Corp. files its corporate franchise tax returns using a calendar year, the test year for the employment test is calendar year 2004. The base period for the employment test for ABC Corp. is the 5 taxable years prior to the test year, or in this case, calendar years 1999, 2000, 2001, 2002, and 2003.*

*ABC Corp. will use taxable year 2005 in calculating its employment test to determine its continued eligibility to receive sales and use tax benefits for taxable year 2006. At that time, since ABC Corp. will use a taxable year beginning on or after January 1, 2005, in determining whether it meets the employment test, ABC Corp.'s base period is the 3 taxable years prior to the test year, i.e., calendar years 2001, 2002, and 2003.*

## **Other changes**

### **New business**

For employment tests using a taxable year beginning on or after January 1, 2005, a business enterprise certified under the GML on or after August 1, 2002, which is identical in ownership and operation to an existing taxpayer may qualify as a new business if the two business enterprises are operating in different counties of the state. However, where the existing taxpayer is a QEZE, the benefit period of the new business enterprise will be limited to the remainder of the benefit period of the existing taxpayer.

*Example: XYZ Pizzeria, Inc. became certified under the GML in County A in 2003. The corporation decided to expand and open a second location, to be operated by XYZ Pizzeria II, Inc., in County B in 2006. Mr. and Mrs. M own all of the stock of XYZ Pizzeria, Inc. and XYZ Pizzeria II, Inc. Assuming all of the other qualifications are met, XYZ Pizzeria II, Inc. will qualify as a new business, even though it is owned and operated by the same people who own XYZ Pizzeria, Inc., because it is operating in a different county. However, the sales and use tax benefit period for XYZ Pizzeria II, Inc. is the same 120 month period that applies to XYZ Pizzeria, Inc.*

### **Related persons**

In calculating the employment test, a QEZE's employment number excludes individuals who were employed by a related person within the immediately preceding 60 months. For employment tests using taxable years beginning on or after January 1, 2005, only individuals employed within the state by the related person are excluded under this provision. In addition, effective for employment tests using taxable years beginning on or after January 1, 2002, the term *related person* includes an entity that would have qualified as a related person if it had not been dissolved, liquidated, merged with another entity, or otherwise ceased to exist or operate.