New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-M-03(4)C
TSB-M-03(3)I
Corporation Tax
Income Tax
June 12, 2003

Qualified Empire Zone Enterprise (QEZE) Tax Credits

On May 29, 2002, Governor George E. Pataki signed Chapter 85 of the Laws of 2002. This legislation, in part, amended the Tax Law to make clarifications to the *Empire Zones Program Act*. This TSB-M includes information from prior legislation (Ch. 63, L. 2000) and from Chapter 85 of the Laws of 2002. As a result, this TSB-M supersedes TSB-M-01(1)C and TSB-M-01(1)I.

The following is a summary of changes to the Empire Zones Program resulting from the new legislation:

- the effective date for Empire Zone designations has been extended for tax purposes;
- definitions of *employment test, employment number, taxable year, test date, test year*, and *eligible real property taxes* have been amended;
- the benefit period has been renamed the *business tax benefit period* and redefined;
- limitation and recapture provisions were added to the QEZE Credit for Real Property Taxes; and
- the computation of the tax factor for flow-through entities and combined filers has been codified.

Business enterprises whose eligibility for the QEZE Real Property Tax Credit or QEZE Tax Reduction Credit may be affected by the changes regarding the employment test, employment number, test year and eligible real property taxes are those enterprises that:

- have employees who were employed by a related person (as *related person* is defined in the Internal Revenue Code);
- have employees in Empire Zones in which they are not certified;
- relocated to an Empire Zone from a business incubator facility;
- are located in an Empire Zone as a result of a boundary amendment;
- were certified under Article 18-B of the General Municipal Law on the last day of their taxable year, so that these businesses now will have a different base period based on the amended definition of test year;
- make payments in lieu of taxes (PILOT payments).

Unless otherwise noted, these changes are deemed to have been in effect since January 1, 2001.

General Information

The Empire Zones Program Act was added to the Tax Law by Chapter 63 of the Laws of 2000, and applies to taxable years beginning on or after January 1, 2001. The Act provided for two new credits against corporate and personal income taxes for Qualified Empire Zone Enterprises (QEZEs) subject to tax under Articles 9-A (Franchise Tax on Business Corporations), 22 (Personal Income Tax), 32 (Franchise Tax on Banking Corporations) or 33 (Franchise Tax on Insurance Corporations) of the Tax Law. QEZEs that annually meet an employment test are entitled to the QEZE Credit for Real Property Taxes for eligible real property taxes imposed on zone property and the QEZE Tax Reduction Credit. The Act also changed the term *economic development zone* to *Empire Zone* wherever it appeared in the Consolidated or Unconsolidated Laws of New York. Chapter 85 of the Laws of 2002 made technical amendments to these QEZE tax credits.

The QEZE tax credits are generally available for 14 taxable years provided the QEZE annually meets the employment test (described below). The legislation provides that a business enterprise may be a QEZE for up to 15 years (the business tax benefit period). However, because the benefit period factor for year 15 is 0, there are no credits available for that year.

Section 969(a) of Article 18-B of the General Municipal Law provides that a designation of an area as an Empire Zone will remain in effect during the period beginning on the date of designation, and ending July 31, 2004. The Tax Law was amended by Chapter 85 to provide that if the designation of an area as an Empire Zone is no longer in effect because section 969 of the General Municipal Law was not amended to extend the effective date of such designation beyond July 31, 2004, a business enterprise that was certified pursuant to Article 18-B of the General Municipal Law on July 31, 2004, will be deemed to continue to be certified for purposes of the QEZE tax benefits. In addition, all references to Empire Zones in the provisions of the Tax Law concerning QEZEs shall be read as meaning areas designated as Empire Zones on July 31, 2004.

A business enterprise that received QEZE credits in a prior tax year but no longer meets the eligibility requirements as a result of the changes made in Chapter 85 of the Laws of 2002 is **not** required to amend its tax returns for previous years. However, for tax returns not yet filed, the enterprise must use the rules set forth in this memorandum when determining the employment test, employment number, and test year.

General definitions

A ***Qualified Empire Zone Enterprise*** (QEZE) means a business enterprise that has been certified under Article 18-B of the General Municipal Law prior to July 1, 2005, which annually meets an employment test, during the business tax benefit period.

The ***business tax benefit period*** consists of :

- the first fifteen taxable years beginning on or after January 1, 2001, for businesses with a test date occurring on or before December 31, 2001, or

- the first fifteen taxable years following the test year for businesses with a test date occurring on or after January 1, 2002.

The ***employment test*** will be met for a taxable year if: (i) the business enterprise's employment number in all Empire Zones for the taxable year equals or exceeds its employment number in all Empire Zones for the base period, and (ii) the business enterprise's employment number in New York State outside of the Empire Zones for the taxable year equals or exceeds its employment number in the State outside of the Empire Zones for the base period.

Taxable year means the tax year of the business enterprise under Section 183, 184, 185 or former Section 186 of Article 9 (Corporation Tax), or under Article 9-A (Franchise Tax on Business Corporations), Article 22 (Personal Income Tax), Article 32 (Franchise Tax on Banking Corporations), or Article 33 (Franchise Tax on Insurance Corporations) of the Tax Law. If a business enterprise does not have a taxable year under the preceding sentence because it is exempt from taxation or otherwise not required to file a tax return under any of the above-referenced sections or articles, then *taxable year* means the business enterprise's taxable year for federal income tax purposes, or, if the enterprise does not have a taxable year for federal income tax purposes, the calendar year.

Employment number means the average number of individuals (excluding general executive officers, in the case of a corporation) employed full-time by the business enterprise for at least one-half of the taxable year. The number of these individuals who are employed full-time by the business enterprise for at least one-half of the taxable year is computed by: (i) determining the number of individuals so employed on March 31, June 30, September 30, and December 31 during the applicable taxable year; (ii) adding together the number of such individuals determined on each of those dates; and (iii) dividing the sum by the number of such dates occurring within the applicable taxable year. ***Employed full-time*** means a job consisting of at least 35 hours per week and includes two or more jobs that together constitute the equivalent of a job of at least 35 hours per week. A seasonal business (a business that regularly operates for less than an entire tax year, e.g., ski resort) that employs individuals full-time for at least three months of continuous duration may include those individuals in the employment number.

Note: For purposes of the *employment test,* for taxable years beginning on or after January 1, 2002, the employment number for the taxable year and base period will not include individuals employed within the immediately preceding 60 months by a *related person* to the QEZE as defined in Internal Revenue Code (IRC), section 465(b)(3)(C). (See attached Addendum on page 23).

Test date means the later of July 1, 2000, or the date prior to July 1, 2005, on which the business enterprise was first certified under Article18-B of the General Municipal Law. Accordingly, a business enterprise that has been certified under the General Municipal Law prior to July 1, 2000, is deemed to have a test date of July 1, 2000. That business enterprise does not need to be recertified under Article 18-B to qualify for the QEZE benefits.

Test year means the last taxable year of the business enterprise ending **before** the test date. If a business enterprise does not have a taxable year that ends before the test date, then the enterprise will be deemed to have a test year that is either the last calendar year ending before its test date or, if the enterprise has as its taxable year a fiscal year, the last such fiscal year ending before its test date. (Previously, *test year* was defined as the last taxable year ending **on or** before the test date.)

Base period means the five taxable years immediately before the test year. If a business enterprise has fewer than five taxable years before the test year, then the term *base period* will mean the smaller set of taxable years. In the case of a business enterprise that is first doing business in New York State in the year the enterprise is certified, the employment number in the base period is zero. (See *Employment test for businesses with a base period of zero years* below.)

Newly designated empire zones or changes in empire zone boundaries

In the case of a newly designated zone or if the boundaries of an existing 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 business enterprise had been located in the new or revised zone.

Relocation from a business incubator facility

If a business enterprise relocates to an Empire Zone from a business incubator facility operated by a municipality or by a public or private not-for-profit entity which provides space or business support services or both to newly established enterprises, the employment number in the base period is determined as if such business enterprise had been located in the Empire Zone during the base period.

Employment test for businesses with employees in Empire Zones in which they are not certified

Prior to the enactment of Chapter 85 of the Laws of 2002, the employment test was met for a taxable year if: (i) the business enterprise's employment number in Empire Zones in which the business enterprise is certified under Article 18-B of the General Municipal Law for the taxable year equaled or exceeded its employment number in such zones for the base period, and (ii) the business enterprise's employment number in New York State outside of the Empire Zones for the taxable year equaled or exceeded its employment number in the State outside of such zones for the base period.

In applying the two-part employment test as originally enacted, a business enterprise that had employees in an Empire Zone in which it was **not** certified under Article 18-B of the General Municipal Law would have included those employees in the employment numbers for part (ii) of the test (employees located outside the zone, but within New York State). However, under the amended definition of employment test, all the enterprise's qualifying employees in Empire Zones are included in the employment numbers for part (i) (employees located within the zone) of the employment test, regardless of whether the enterprise is certified in all of those zones.

Employment test for businesses with a base period of zero years

The employment test described below for business enterprises with a base period of zero years is effective August 1, 2002, and does **not** apply to any business enterprise that was certified under

Article 18-B of the General Municipal Law prior to August 1, 2002, or to any business enterprise that has received a written letter of commitment regarding Empire Zone benefits from the Department of Economic Development prior to August 1, 2002. Generally, a business enterprise will be considered to be certified prior to August 1, 2002, if the effective date on its *Empire Zones Program Certificate of Eligibility* is prior to August 1, 2002.

If the base period is zero years and the enterprise has an employment number in such zone(s) of greater than zero with respect to a taxable year, then the employment test will be met only if the enterprise qualifies as a *new business* as defined below.

For purposes of the preceding paragraph, a ***new business*** is any business entity, except one which is substantially similar in operation and in ownership to a business entity taxable, or previously taxable, under sections 183, 184, 185, or 186 of Article 9 of the Tax Law; or under Article 9-A, 32, or 33 of the Tax Law; or under Article 23, or which would have been subject to Article 23 (as such article was in effect on January 1, 1980), or the income (or losses) of which is (or was) includable under Article 22 of the Tax Law.

QEZE Credit for Real Property Taxes

Who is eligible

A taxpayer that is subject to tax under Article 9-A, 22, 32 or 33 of the Tax Law and is a QEZE, a sole proprietor of a QEZE, a shareholder of a New York S corporation that is a QEZE, or a partner of a partnership that is a QEZE, is allowed a credit against its Article 9-A, 22, 32 or 33 tax, for eligible real property taxes imposed on property owned by the QEZE. For purposes of this TSB-M, the term partnership includes an LLC which has elected to be treated as a partnership for federal income tax purposes and partner includes a member of an LLC which has elected to be treated as a partnership.
(Tax Law, section 15(a))

Definitions

The ***benefit period factors*** to be used in calculating the QEZE credit for real property taxes are listed in the following table:

Taxable year of the benefit period	Benefit period factor
Years 1-10	1.0
Year 11	.8
Year 12	.6
Year 13	.4
Year 14	.2
Year 15	0

The ***employment increase factor*** is an amount which cannot exceed 1, but that is the greater of the following:

(1) The excess of the QEZE's employment number in the Empire Zones in which the QEZE is certified under Article 18-B of the General Municipal Law for the taxable year, over the QEZE's test year employment number in such empire zones, divided by the QEZE's test year employment number in the zones in which the QEZE is certified. (Note: Where a QEZE's employment number in the zones for the taxable year exceeds the QEZE's employment number in the zones for the test year, and the test year employment number is zero, the employment increase factor will be 1.0); **or**

(2) The excess of the QEZE's employment number in zones in which the QEZE is certified under Article 18-B of the General Municipal Law for the taxable year, over the QEZE's test year employment number in such zones, divided by 100.

Eligible real property taxes means the taxes imposed on real property that is owned by the QEZE and located in an Empire Zone in which the QEZE is certified under Article 18-B of the General Municipal Law. The real property taxes must become a lien on the real property in a taxable year in which the owner of the property is both certified under Article 18-B of the General Municipal Law and a QEZE. In general, the lien date is the first day of the period for which the taxes are imposed.

Payments in lieu of taxes (PILOTs) made to the State, a municipal corporation or a public benefit corporation for property owned by the QEZE and located in an empire zone in which the QEZE is certified are considered eligible real property taxes if the PILOTs are made by the QEZE pursuant to a written agreement. However, PILOTs made by a QEZE pursuant to a written agreement executed or amended on or after January 1, 2001, do not constitute eligible real property taxes unless the written agreement is approved by both the Department of Economic Development and the Office of Real Property Services as satisfying generally accepted and recognized norms and standards of real property tax appraisals.

(Tax Law, section 15(c) through (e))

Amount of credit

The amount of the credit is the product (or pro rata share of the product, in the case of a shareholder of a New York S corporation or a partner of a partnership) of the following three factors:

(1) the benefit period factor;
(2) the employment increase factor; and
(3) the eligible real property taxes, paid or incurred by the QEZE, during the taxable year.

(1) x (2) x (3) = Amount of QEZE Credit for Real Property Taxes

(Tax Law, section 15(b)

Limitation on the amount of credit

A limitation on the amount of QEZE Credit for Real Property Taxes which may be claimed in a taxable year was added for taxpayers that are certified under Article 18-B of the General Municipal Law on or after August 1, 2002.

The credit is limited to the greater of the following two amounts:

(1) The employment increase limitation, which is the product of (A) $10,000 and (B) the excess of the QEZE's employment number in the zones in which the QEZE is certified for the taxable year, over the QEZE's test year employment number in such zones, **or**

(2) The capital investment limitation, which is the product of (A) 10% of the cost or other basis of the real property and (B) the greater of:

- the percentage of the real property physically occupied and used by the QEZE or by a related person to the QEZE, as *related person* is defined in IRC section 465(b)(3)(c) (see attached addendum); **or**

- the percentage of the cost or other basis attributable to the construction, expansion or rehabilitation of the real property (as opposed to the acquisition) by 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 this percentage shall be deemed to be 100%.

The *cost or other basis* of the real property is the greater of:

- the cost or other basis for federal income tax purposes on the later of January 1, 2001, or on the effective date of the QEZE's certification under Article 18-B of the General Municipal Law, of real property, including buildings and structural components of buildings, owned by the QEZE and located in Empire Zones in which the QEZE is certified ; **or**

- the cost or other basis for federal income tax purposes, of the real property (as described above) on the last day of the tax year in which the QEZE is claiming the credit.

Any taxpayer certified under Article 18-B of the General Municipal Law before August 1, 2002, is not subject to this limitation in any year of the business tax benefit period.

(Tax Law, section 15(f))

Application and refund of the credit

The legislation provides that a business enterprise may be a QEZE for up to 15 years. However, since the benefit period factor for year 15 is zero, there is no credit available for that year.

The credit will be available for each of the first 14 years during the business tax benefit period, but only for those taxable years for which the employment test is met.

A business enterprise that becomes a certified Empire Zone business under Article 18-B of the General Municipal Law and subsequently has its certification revoked under that article will cease to be a QEZE on the first day of the taxable year in which the business enterprise's certification is revoked for purposes of Articles 9-A, 22, 32 and 33.

For Article 9-A taxpayers, the credit deducted for each taxable year cannot reduce the tax to an amount less than the tax due on the minimum taxable income base or the fixed dollar minimum, whichever is higher.

For Article 32 and 33 taxpayers, the credit deducted for each taxable year cannot reduce the tax to an amount less than the fixed minimum tax of $250.

For Article 22 taxpayers, the credit deducted for each taxable year can reduce the tax to zero.

The credit may not be applied against the MTA surcharge under Article 9-A, 32, or 33.

Any amount of the credit not deductible in the current taxable year may be credited or refunded. The Tax Law does not allow for the payment of interest on the refund.

(Tax Law, section 14(i), 210.27, 606(bb), 1456(o) and 1511(r))

Recapture of credit

For taxable years beginning on or after January 1, 2001, a portion of the QEZE real property tax credit must be recaptured if the amount of the real property taxes on which the credit was calculated is subsequently reduced by a final order in any proceeding under Article 7 of the Real Property Tax Law or other provision of law. The recapture amount is equal to the amount of the credit originally taken, less the amount of credit recalculated using the reduced real property taxes.

(Tax Law, section 15(g))

QEZE Tax Reduction Credit

Who is eligible

A taxpayer that is subject to tax under Article 9-A, 22, 32 or 33 of the Tax Law and is a QEZE, a sole proprietor of a QEZE, a shareholder of a New York S corporation that is a QEZE, or a partner of a partnership that is a QEZE, is allowed a credit against its Article 9-A, 22, 32 or 33 tax, based on the following rules and additional definitions. For purposes of this TSB-M, the term "partnership" includes an LLC which has elected to be treated as a partnership for federal income tax purposes and "partner" includes a member of an LLC which elects to be treated as a partnership.

(Tax Law, section 16(a))

Definitions

The ***zone allocation factor*** is the percentage that represents the QEZE's economic presence in Empire Zones in which the QEZE is certified under Article 18-B of the General Municipal Law.

The zone allocation factor is calculated by adding the two percentages determined in (1) and (2) below and then dividing the result by 2.

(1) Determine the percentage of the QEZE's real and tangible personal property in Empire Zones by dividing the average value of the QEZE's real and tangible personal property, whether owned or rented to it, in Empire Zones in which the QEZE is certified, during the period covered by its return, by the average value of all the QEZE's real and tangible personal property, whether owned or rented to it, within the state during that period.

Value of the QEZE's real and tangible personal property means the adjusted basis of the properties for federal income tax purposes (except that the value of rental property shall be eight times the gross rents payable by the QEZE for the rental property for the taxable year). However, if a QEZE has made a one-time, revocable election, which has not been revoked, to use fair market value as the value of all of its real and tangible personal property for purposes of the property factor of the business allocation percentage, the QEZE may also use fair market value for purposes of this computation.

(2) Determine the percentage of the QEZE's wages in Empire Zones by dividing the total wages, salaries, and other personal service compensation computed on the cash or accrual basis according to the method of accounting used by the QEZE in the computation of entire net income, during the taxable year, of employees within Empire Zones in which the QEZE is certified, except general executive officers, by the total wages, salaries and other personal service compensation, similarly computed, during the taxable year, of all the QEZE's employees within the state, except general executive officers.

For Article 22 (personal income tax) purposes, references in the zone allocation factor to property, wages, salaries, and other personal service compensation are considered to be references to those items connected only with the conduct of the QEZE business. Therefore, the reference to entire net income in (2) above, would be net profit (loss) or ordinary income (loss) of the QEZE for Article 22 purposes.

(Tax Law, section 16(e))

The ***tax factor*** is calculated as detailed below. In all cases, the tax used to compute the credit is the tax before any deduction for credits. In no event may any of these ratios exceed 1.0. The Commissioner of the Department of Taxation and Finance may prescribe other methods which reasonably reflect the portion of tax attributable to the QEZE.

The ***tax factor*** for **corporate taxpayers** is calculated as follows:

(1) Article 9-A: The larger of the tax on the entire net income base or the minimum taxable income base.

(2) Article 32: The larger of the tax on entire net income or the alternative entire net income.

(3) Article 33: The larger of the tax on entire net income or entire net income plus compensation.

The ***tax factor*** for **corporate partners** is the larger of the applicable tax determined in (1) through (3) above, multiplied by a ratio, the numerator of which is the *partner's income from the QEZE partnership* allocated within New York State and the denominator of which is the *partner's entire income* allocated within New York State. The term *partner's income from the QEZE partnership* means partnership items of income, gain, loss, deduction and New York modifications entering into entire net income, minimum taxable income, alternative entire net income, or entire net income plus compensation, as the case may be. If the partner's income from the partnership is zero or a loss, the tax factor is zero. The term *partner's entire income* means entire net income, minimum taxable income, alternative entire net income, or entire net income plus compensation, as the case may be. The Commissioner of the Department of Taxation and Finance may prescribe other methods which reasonably reflect the portion of tax attributable to the QEZE.

Example of tax factor calculation for corporate partners:

A corporation is a partner of a partnership that is a QEZE. The corporation's entire net income (ENI) before allocation is $1000. The corporation's entire net income before allocation is comprised of $600 business income and $400 investment income. The corporation's pro rata share of the QEZE partnership income is $300 (included in total ENI of $1000), of which $200 is includable in business income and $100 is includable in investment income. The business allocation percentage (BAP) of the corporation is 40% and the investment allocation percentage (IAP) of the corporation is 70%. The New York State tax rate to be used for purposes of this example is 7.5%. The tax factor for this corporate partner of a QEZE partnership is calculated as follows:

Corporation's tax on ENI allocated to New York State

Corporation's Total ENI	$1000	
Corporation's Total ENI allocated to New York State		
Business income x BAP = $600 x 40%	$ 240	
Investment income x IAP = $400 x 70%	$ 280	
Total corporation ENI allocated to New York State		$ 520
New York State tax on allocated New York ENI		$ 520 x 7.5% = $ 39.00

Corporation's pro rata share of QEZE partnership income allocated to New York State*

Corporation's pro-rata share of QEZE partnership income included in ENI $300

Allocated QEZE partnership income

QEZE partnership income includable in corporation's business income x BAP = $200 x 40% = $ 80
QEZE partnership income includable in corporation's investment income x IAP = $100 x 70% = $ 70

Corporation's pro rata share of QEZE partnership income allocated to New York State $150

Tax factor calculation

$$\frac{\text{QEZE partnership income allocated to New York State}}{\text{Corporation's allocated New York ENI}} = \frac{\$\,150}{\$\,520} = .2885 \text{ QEZE allocation ratio}$$

Tax factor :

New York tax on allocated ENI x QEZE allocation ratio = Corporate partner's tax factor

$ 39.00 x .2885 = $ 11.25 tax factor

* The partnership income is allocated to New York State using the corporation's BAP and IAP since those are the ratios used to allocate partnership items of business and investment income to New York State for purposes of calculating the corporation's New York State tax.

The ***tax factor*** for **corporations who file a combined report** is the amount of combined tax (the larger of the applicable tax determined in (1) through (3) above) multiplied by a ratio, the numerator of which is the amount of income of the QEZE allocated to New York State, and the denominator of which is the combined group's income. Combined groups which have one or more members with losses (including the QEZE) compute the tax factor as described above without including the loss(es) in either the numerator or the denominator. The Commissioner of the Department of Taxation and Finance may prescribe other methods which reasonably reflect the portion of tax attributable to the QEZE.

The ***tax factor*** for **personal income tax taxpayers** is the tax required to be shown on the personal income tax return (as computed under section 601 paragraphs (a) through (d) of the Tax Law) multiplied by the following ratios. In no event may any of these ratios exceed 1.0.

(1) Sole proprietors of QEZEs: The numerator of the ratio is the income from the QEZE (net profit from federal Schedule C and any modifications required under section 612 of the New York State Tax Law) which is allocable to New York State and included in the sole proprietor's New York adjusted gross income. If the QEZE's income is zero or a loss, the tax factor is zero. The income from the QEZE allocable to New York State is the QEZE's income from New York State sources. For a nonresident of New York State, this is the income from the QEZE included in the New York State amount column of Form IT-203, *Nonresident and Part-Year Resident Income Tax Return*. The denominator of the ratio is

New York adjusted gross income as shown on the sole proprietor's New York State return. Personal income tax taxpayers who have included losses in the computation of their New York State adjusted gross income compute the tax factor as described above without regard to the loss(es).

(2) Personal income tax taxpayers that are partners of QEZE partnerships: The numerator of the ratio is the partner's income from the QEZE partnership allocable to New York State and included in New York adjusted gross income. The term "partner's income from the QEZE partnership" means partnership items of income, gain, loss, deduction and modifications entering into New York adjusted gross income. If the partner's income from the QEZE partnership is zero or a loss, the tax factor is zero. The income from the QEZE allocable to New York State is the QEZE partnership income from New York State sources. (This should be provided to the partner by the partnership.) For a nonresident of New York State, this is the partnership income from the QEZE partnership included in the New York State amount column of Form IT-203, *Nonresident and Part-Year Resident Income Tax Return.* The denominator of the ratio is New York adjusted gross income as shown on the partner's New York State tax return. Personal income tax taxpayers who have included losses in the computation of their New York State adjusted gross income compute the tax factor as described above without regard to the loss(es).

(3) Shareholders of New York S corporations which are QEZEs: The numerator of the ratio is the shareholder's income from the New York S corporation which is a QEZE allocable to New York State and included in New York adjusted gross income. Do not include any wages paid by the QEZE S corporation to the shareholder in the shareholder's income from the QEZE S corporation allocable to New York State. If the shareholder's income from the QEZE S corporation is zero or a loss, the tax factor is zero. The income from the QEZE S corporation allocable to New York State is the QEZE S corporation income from New York State sources. (This should be provided to the shareholder by the New York S corporation.) For a nonresident of New York State, this is the New York S corporation income from the QEZE S corporation included in the New York State amount column of Form IT-203, *Nonresident and Part-Year Resident Return.* The denominator of the ratio is New York adjusted gross income as shown on the shareholder's return. Personal income tax taxpayers who have included losses in the computation of their New York State adjusted gross income compute the tax factor as described above without regard to the loss(es).

These provisions are effective for all tax years.

(Tax Law, section 16(f))

Amount of credit

The amount of the credit is the product of the following four factors:

(1) the benefit period factor;
(2) the employment increase factor;
(3) the zone allocation factor; and
(4) the tax factor.

(1) x (2) x (3) x (4) = Amount of QEZE Tax Reduction Credit

(Tax Law, section 16(b))

Application of the credit

The legislation provides that a business enterprise may be a QEZE for up to 15 years. However, since the benefit period factor for year 15 is zero, there is no credit available for that year. The credit will be available for each of the first 14 years during the business tax benefit period, but only for those taxable years for which the employment test is met.

A business enterprise that becomes a certified Empire Zone business under Article 18-B of the General Municipal Law and subsequently has its certification revoked under that article will cease to be a QEZE on the first day of the taxable year in which the business enterprise's certification is revoked for purposes of Articles 9-A, 22, 32 and 33.

For Article 9-A taxpayers , the credit deducted for each taxable year cannot reduce the tax to an amount less than the fixed dollar minimum. However, Article 9-A taxpayers that have a zone allocation factor of 100% are not subject to this limitation and the credit deducted for each taxable year can reduce the tax to zero.

For Article 32 and 33 taxpayers, the credit deducted for each taxable year cannot reduce the tax to an amount less than the fixed minimum tax of $250.

For Article 22 taxpayers, the credit deducted for each taxable year can reduce the tax to zero.

The credit may not be applied against the MTA surcharge under Article 9-A, 32, or 33.

Any amount of the credit not deductible in the current taxable year may not be credited, carried over or refunded.

(Tax Law, Sections 14(i), 210.28, 606(cc), 1456(p) and 1511(s))

EXAMPLE 1

Company ABC, a corporation subject to tax under Article 9-A, was incorporated in New York State on January 2, 1990, and became zone-certified under Article 18-B of the General Municipal Law on July 15, 2001 (the test date). For tax purposes, Company ABC files on a calendar year basis. Company ABC conducts business in only one zone in which it is certified, and has no other operations in New York State outside Empire Zones (EZs).

Part 1: EMPIRE ZONE EMPLOYEES - Computation of average number of employees (excluding general executive officers) employed full-time for at least one-half of the taxable year within all zones for the current taxable year and the five-year base period.

	Year	March 31	June 30	September 30	December 31	Total	Average # of employees
Number of full-time employees within all EZs for the current taxable year:	**2002**	**51**	**51**	**51**	**50**	**203**	**50.75**
Number of full-time employees within all EZs for the five-year base period:							
Base Year 1:	**1996**	**31**	**31**	**30**	**30**	**122**	
Base Year 2:	**1997**	**30**	**30**	**32**	**32**	**124**	
Base Year 3:	**1998**	**31**	**31**	**30**	**30**	**122**	
Base Year 4:	**1999**	**30**	**30**	**30**	**30**	**120**	
Base Year 5:	**2000**	**30**	**30**	**30**	**30**	**120**	
Total full-time employees within all EZs for the five-year base period:						**608**	
Average full-time employees within all EZs in the five-year base period (total divided by the number of dates in base period, in this example there are 20):							**30.40**

The average number of full-time employees within all EZs (employment number) in the current taxable year exceeds the average number of full-time employees within all EZs (employment number) for the base period.

Part 2: NEW YORK STATE EMPLOYEES OUTSIDE EMPIRE ZONES- Computation of average number of employees (excluding general executive officers) employed full-time for at least one-half of the taxable year in New York State outside all Empire Zones (EZs) for the current taxable year and five-year base period.

	Year	March 31	June 30	September 30	December 31	Total	Average # employees
Number of full-time employees in New York State outside EZs for the current taxable year:	**2002**	**0**	**0**	**0**	**0**	**0**	**0**
Number of full-time employees in New York State outside EZs for the five-year base period:							
Base Year 1:	**1996**	**0**	**0**	**0**	**0**	**0**	
Base Year 2:	**1997**	**0**	**0**	**0**	**0**	**0**	
Base Year 3:	**1998**	**0**	**0**	**0**	**0**	**0**	
Base Year 4:	**1999**	**0**	**0**	**0**	**0**	**0**	
Base Year 5:	**2000**	**0**	**0**	**0**	**0**	**0**	
Total full-time employees in New York State outside EZs for the five-year base period						**0**	
Average full-time employees in New York State outside EZs in the five-year base period (total divided by the number of dates in base period, in this example there are 20):							**0**

The average number of full-time employees in New York State outside Empire Zones (employment number) in the current taxable year equals the average number of full-time employees in New York State outside Empire Zones (employment number) for the base period.

The employment test for taxable year 2002 has been satisfied since both Parts 1 and 2 of the employment test have been met.

Part 3: TEST YEAR EMPLOYMENT NUMBER- Computation of average number of full time employees (excluding general executive officers) for the test year (taxable year ending 12/31/2001). Include only employees working in zones in which the QEZE is certified.

	Year	March 31	June 30	September 30	December 31	Total	Average #
Number of full-time employees in all EZs for the test year:	**2001**	**40**	**40**	**40**	**40**	**160**	**40**

Part 4: CALCULATION OF THE AMOUNTS OF EMPIRE ZONES CREDITS

<u>CREDIT FOR REAL PROPERTY TAXES:</u>

Company ABC is a QEZE because it is a zone-certified business and has met the employment test for the current taxable year. Company ABC paid $75,000 of real property taxes in the current taxable year.

Current Taxable Year Ending 12/31/2002		**Computation**
Factor 1: Benefit period factor **Years one through ten, enter 1.0**		**1.0**
Factor 2: Employment increase factor		
A. Average employment within the zones in which the taxpayer is certified in current taxable year	**50.75**	
Average employment within the zones in which the taxpayer is certified in test year	**40**	
Excess of employment for taxable year over test year, divided by test year employment (50.75 - 40 = 10.75) ÷ 40 =	**.2688**	
B. Average employment within the zones in which the taxpayer is certified in current taxable year	**50.75**	
Average employment within the zones in which the taxpayer is certified in test year	**40**	
Excess of employment for taxable year over test year, divided by 100 (50.75 - 40 = 10.75) ÷ 100 =	**.1075**	
Higher of "A" or "B" above, not to exceed 1.0		**.2688**
Factor 3: Real Property taxes paid or incurred during taxable year		**$75,000.00**
Credit for Real Property Taxes in current taxable year: Product of factors 1, 2, and 3		**$20,160.00**

TAX REDUCTION CREDIT:

Company ABC computes $500,000 of tax on its entire net income base for its taxable year ending 12/31/2002, which is greater than the amount of tax on its minimum taxable income base. It has $5,000,000 of property and $1,000,000 of payroll within the zone in which it is certified in the current tax year. All of Company ABC's New York property and payroll is located within this zone.

Current Taxable Year Ending 12/31/2002		Computation
Factor 1: Benefit period factor Year one through ten, enter 1.0		1.00
Factor 2: Employment increase factor		
A. Average employment within all EZs in current tax year Average employment within all EZs in test year Excess of employment for taxable year over test year divided by test year employment (50.75 - 40 = 10.75) ÷ 40 =	 50.75 40 .2688	
B. Average employment within all EZs in current taxable year Average employment within all EZs in test year Excess of employment for the taxable year over test year divided by 100 (50.75 - 40 = 10.75) ÷ 100 =	50.75 40 0.1075	
Higher of "A" or "B" above, not to exceed 1.0		0.2688
Factor 3: Zone allocation factor		
A. Zone property in taxable year New York State property in taxable year Zone property percentage $5,000,000 ÷ $5,000,000 =	$5,000,000 $5,000,000 100%	
B. Zone payroll in taxable year New York State payroll in taxable year Zone payroll percentage $1,000,000 ÷ $1,000,000 =	$1,000,000 $1,000,000 100%	
C. Total of zone property and payroll percentages divided by 2 (100% + 100% =200%) ÷ 2 = 100%		1.00
Factor 4: Tax Factor - amount of tax on entire net income base		$500,000.00
Tax Reduction Credit for current taxable year: Product of factors 1, 2, 3, and 4		$134,400.00

EXAMPLE 2

Company XYZ, a corporation subject to tax under Article 9-A, was incorporated in New York State on January 15, 1990 and became zone-certified by the Commissioner of Economic Development on December 31, 2002 (test date). For tax purposes, Company XYZ files its tax return on a calendar year basis. Company XYZ has business activity in New York State both inside and outside empire zones. Company XYZ is certified in one empire zone.

EMPLOYMENT TEST:

Part 1: ZONE EMPLOYEES - Computation of average number of employees (excluding general executive officers) employed full-time for at least one-half of the taxable year within all zones for the current taxable year (year claiming the credit) and five year base period.

	Year	March 31	June 30	September 30	December 31	Total	Average # employees
Number of full-time employees within all EZs for the current taxable year:	**2002**	**430**	**430**	**430**	**430**	**1720**	**430**
Number of full-time employees within all EZs during the five-year base period:							
Base Year 1:	**1996**	**350**	**350**	**350**	**350**	**1400**	
Base Year 2:	**1997**	**350**	**350**	**350**	**350**	**1400**	
Base Year 3:	**1998**	**350**	**350**	**350**	**350**	**1400**	
Base Year 4:	**1999**	**350**	**350**	**350**	**350**	**1400**	
Base Year 5:	**2000**	**350**	**350**	**350**	**350**	**1400**	
Total full-time employees within all EZs for the five-year base period:						**7,000**	
Average full-time employees within all EZs in the five-year base period (total divided by the number of dates in base period, in this example there are 20 dates):							**350**

The average number of full-time employees within all EZs (employment number) in the current taxable year exceeds the average number of full-time employees within all EZs (employment number) for the base period.

Part 2: NON-ZONE NEW YORK STATE EMPLOYEES - Computation of average number of employees (excluding general executive officers) employed full-time for at least one-half of the taxable year in New York State outside the zones for the current taxable year and five year base period.

	Year	March 31	June 30	September 30	December 31	Total	Average # employees
Number of full-time employees in New York State outside the EZs for the current taxable year:	**2002**	**300**	**300**	**300**	**300**	**1200**	**300**
Number of full-time employees in New York State outside the EZs for the five-year base period:							
Base Year 1:	**1996**	**200**	**200**	**200**	**200**	**800**	
Base Year 2:	**1997**	**200**	**200**	**200**	**200**	**800**	
Base Year 3:	**1998**	**200**	**200**	**200**	**200**	**800**	
Base Year 4:	**1999**	**200**	**200**	**200**	**200**	**800**	
Base Year 5:	**2000**	**200**	**200**	**200**	**200**	**800**	
Total full-time employees in New York State outside the EZs for the five-year base period:						**4,000**	
Average full-time employees in New York State outside of the EZs in the five-year base period (total divided by 20 or number of dates in base period):							**200**

The average number of full-time employees in New York State outside all EZs (employment number) in the current taxable year exceeds the average number of full-time employees in New York State outside all EZs (employment number) for the base period.

The employment test for taxable year 2002 has been satisfied since both Parts 1 and 2 of the employment test have been met.

Part 3: TEST YEAR EMPLOYMENT NUMBER – Computation of average number of full time employees (excluding general executive officers) for the test year (taxable year ending 12/31/2001). Include only employees working in EZs in which the QEZE is certified.

	Year	March 31	June 30	September 30	December 31	Total	Average # employees
Number of full-time employees in EZs in which the QEZE is certified for the test year:	**2001**	**400**	**400**	**400**	**400**	**1600**	**400**

Part 4: COMPUTATION OF THE AMOUNTS OF EMPIRE ZONE CREDITS

CREDIT FOR REAL PROPERTY TAXES:

Company XYZ is a QEZE because it is a zone-certified business and has met the employment test for the current taxable year. Company XYZ paid $140,000 of eligible real property taxes in the current taxable year.

Current Taxable Year Ending 12/31/2002		Computation
Factor 1: Benefit period factor **Years one through ten, enter 1.0**		**1.0**
Factor 2: Employment increase factor		
A. Average employment within the EZ in which the taxpayer is certified in current taxable year	**430**	
Average employment within the EZ in which the taxpayer is certified in test year	**400**	
Excess of employment for taxable year over test year, divided by test year employment (430 - 400 = 30) ÷ 400 =	**0.075**	
B. Average employment within the EZ in which the taxpayer is certified in current taxable year	**430**	
Average employment within the EZ in test year	**400**	
Excess of employment for taxable year over test year divided by 100 (430 - 400 = 30) ÷ 100 =	**0.300**	
Higher of "A" or "B" above, not to exceed 1.0		**0.30**
Factor 3: Real Property taxes paid or incurred during the taxable year		**$140,000.00**
Credit for Real Property Taxes in current taxable year: Product of Factors 1, 2, and 3		**$ 42,000.00**

Company XYZ is subject to the limitation on the amount of QEZE Real Property Tax Credit it may take in any tax year (since it was certified after 8/1/2002). The limitation is the greater of the employment increase limitation or the capital investment limitation, computed as follows:

Limitation of the amount of QEZE Credit for Real Property Tax Credit

Employment increase limitation: Increase in employment number in EZs in which the QEZE is certified in the current year over the test year, times $10,000.

Current year employment number (430) less test year employment number (400) = Increase in employment number (30)

Employment increase (30) x $10,000 = $300,000 Employment increase limitation

Capital investment limitation: 10% of the cost or other basis of the real property times the greater of (1) the percentage of physical occupation of the real property by the QEZE (including related persons) or (2) the percentage of the cost or other basis attributable to the rehabilitation, construction or expansion of the real property.

Company XYZ’s basis of the real property for federal income tax purposes on 12/31/2002 is $7,000,000, and this basis does not include any amounts attributable to the construction, expansion or rehabilitation of the property. The property is 100% occupied by Company XYZ (the QEZE).

Capital investment limitation computation:

10% x basis x percentage of occupation by the QEZE = 10% (.10) x $7,000,000 x 100% (1) = $700,000

Since the capital investment limitation ($700,000) is greater than the employment increase limitation ($300,000), the capital investment limitation is used to determine the maximum amount of QEZE real property tax credit allowed in the current tax year. The amount of QEZE Real Property Tax Credit for the tax year ending 12/31/2002 is $42,000 and does not exceed the limitation.

TAX REDUCTION CREDIT:

Company XYZ has $2,000,000 of tax due on its entire net income base for taxable year ending 12/31/2002, which is greater than the amount of tax on its minimum taxable income base. It has $7,500,000 of property and $4,500,000 of payroll within the zone in this year. Company XYZ also has $7,500,000 of property and $4,500,000 of payroll in New York State outside the zone in this year.

Taxable Year Ending 12/31/2002		**Computation**
Factor 1: Benefit period factor **Year one through ten, enter 1.0**		**1.0**
Factor 2: Employment increase factor		
A. Average employment within the EZ in which the taxpayer is certified in current taxable year	**430**	
Average employment within the EZ in which the taxpayer is certified in test year	**400**	
Excess of employment for taxable year over test year, divided by test year employment **(430 - 400 =30) ÷ 400 =**	**0.075**	
B. Average employment within the EZ in which the taxpayer is certified in current taxable year	**430**	
Average employment within the EZ in test year		
Excess of employment for taxable year over test year	**400**	
divided by 100 **(430 - 400 = 30) ÷ 100 =**	**0.30**	
Higher of "A" or "B" above, not to exceed 1.0		**0.30**
Factor 3: Zone allocation factor (in EZs in which the QEZE is certified)		
A. Zone Property in taxable year	**$7,500,000**	
New York State Property in taxable year	**$15,000,000**	
Zone Property Percentage $7,500,000 ÷ $15,000,000 =	**50%**	
B. Zone Payroll in taxable year	**$4,500,000**	
New York State Payroll in taxable year	**$9,000,000**	
Zone Payroll Percentage $4,500,000 ÷ $9,000,000 =	**50%**	
C. Total of Zone Property and Payroll Percentages divided by 2 (50% + 50% = 100%) ÷ 2 = 50%		**.50**
Factor 4: Tax factor - amount of tax on entire net income base		**$2,000,000.00**
Tax Reduction Credit for current taxable year: Product of factors 1, 2, 3, and 4		**$300,000.00**

Addendum

The information below represents the Internal Revenue Service's interpretation of the definition of *related person* in section 465(b)(3)(C) of the Internal Revenue Code. Section 465 concerns the limitations on deductions to the amounts at-risk and the information below is contained in IRS Publication 925, *Passive Activity and At-Risk Rules – For use in preparing 2001 Returns*. In future years, you should check section 465(b)(3)(C) to see if the definition of *related person* has been amended.

Related persons include:

(1) Members of a family, but only brothers and sisters, half-brothers and half-sisters, a spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.),
(2) Two corporations that are members of the same controlled group of corporations determined by applying a 10% ownership test,
(3) The fiduciaries of two different trusts, or the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts,
(4) A tax-exempt educational or charitable organization and a person who directly or indirectly controls it (or a member of whose family controls it),
(5) A corporation and an individual who owns directly or indirectly more than 10% of the value of the outstanding stock of the corporation,
(6) A trust fiduciary and a corporation of which more than 10% in value of the outstanding stock is owned directly or indirectly by or for the trust or by or for the grantor of the trust,
(7) The grantor and fiduciary, or the fiduciary and beneficiary, of any trust,
(8) A corporation and a partnership if the same persons own over 10% in value of the outstanding stock of the corporation and more than 10% of the capital interest or the profits in the partnership.
(9) Two S corporations if the same persons own more than 10% in value of the outstanding stock of each corporation.
(10) An S corporation and a regular corporation if the same persons own more than 10% in value of the outstanding stock of each corporation,
(11) A partnership and a person who owns directly or indirectly more than 10% of the capital or profits of the partnership,
(12) Two partnerships if the same persons own more than 10% of the capital or profits of each,
(13) Two persons who are engaged in business under common control, and
(14) An executor of an estate and a beneficiary of that estate.

To determine the direct or indirect ownership of the outstanding stock of a corporation, apply the following rules:

(1) Stock owned directly or indirectly by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries.

(2) Stock owned directly or indirectly by or for an individual's family is considered owned by the individual. The family of an individual includes only brothers and sisters, half-brothers and half-sisters, a spouse, ancestors, and lineal descendants.

(3) Any stock in a corporation owned by an individual (other than by applying rule 2) is considered owned directly or indirectly by the individual's partner.

When applying rule (1), (2) ,or (3), stock considered owned by a person under rule (1) is treated as actually owned by that person. However, if a person constructively owns stock because of rule (2) or (3), he or she does not own the stock for purposes of applying either rule (2) or (3) to make another person the constructive owner of the same stock.