

May 1, 2006

Re: Request for Ruling
Unincorporated Business Tax
Relocation Employment Assistance Program

FLR 054844-005

Dear:

This responds to your request, received November 18, 2005, on behalf of (the "Taxpayer"), for a ruling regarding the eligibility of the transaction described below for the New York City Relocation Employment Assistance Program ("REAP") in the context of the Taxpayer's liability under the New York City Unincorporated Business Tax (the "UBT"). This office received additional information regarding this request on January 19, and April 6, 2006.

FACTS

The facts presented are as follows:

The Taxpayer, a New York limited partnership subject to the UBT, wholly owns two single member limited liability companies, ("LLC 1"), and ("LLC 2"). LLC 1 and LLC 2 are treated as disregarded entities for federal income tax purposes.

The Company. The Taxpayer, LLC 1, and LLC 2 are part of a larger business structure engaged primarily in the distribution of building materials and supplies to domestic wholesalers and retailers throughout the northeastern portion of the United States. ("the Company"), the primary operating company in that structure, has been in operation since 1979. The Company does business through six operating entities: ("OE 1. ("OE 2). ("OE 3"), ("OE 4"), ("OE 5") and LLC 2. The Company and the operating entities are owned by and trusts that they control (the "Company's Shareholders").

Through its operating entities, the Company does business at 14 locations. Most of the locations are situated on property primarily owned or controlled by the Company's Shareholders through various other real estate entities. Although owned by different entities, the businesses at those locations

operate to a significant degree as branches of a single entity: they sell the same products and purchase inventory from the same vendors; the locations' accounting and management functions are centralized; they market to many of the same customers; they store inventory for different locations depending on available space; and they use many of the same trucks for deliveries.

The Company and its operating entities have 348 employees, composed of administrative staff, executives, supervisors, managers, drivers, and laborers working within the warehouses. The Company also uses the services of _____ Inc, an employee leasing company, to provide workers for some of its locations. Almost all the employees are paid from the Company, and the cost is allocated among the locations. The Company provides a blanket insurance policy, a 401(k) plan, and a health insurance plan that covers almost all the locations and real estate entities.

The New Location. The Company entered an arrangement with the New York City Industrial Development Agency (the "IDA") to open and operate a building materials and supply business at a new location (the "New Location") , _____ Brooklyn, NY 11211 _____ (the "Property"). The IDA is a corporate governmental agency authorized and established under New York State and City laws to promote economic development in the City. In general, to induce the Taxpayer to keep its business operations in the City, the IDA agreed to provide certain tax and financial benefits to the Company and the Company agreed to develop and operated the New Location, which included renovating and expanding a warehouse to 50,000 square feet. The IDA's assistance took the form of a lease and leaseback. To facilitate that assistance and to provide liability protection, the three-entity structure involving the Taxpayer, LLC 1, and LLC 2 was created as follows:

- LLC 1 was formed on November 4, 2004. It primarily serves as a real estate holding company. It acquired title to the Property, which included a warehouse. LLC 1 is a qualified Empire Zone Enterprise ("QEZE") and its two employees are eligible for QEZE wage tax credits.
- LLC 2 was formed on December 3, 2004, to become an operating company. It will operate the warehouse and the business activity will be reported on its books and records. LLC 2 will also be an employing entity, seeking to hire or lease at least 20 individuals to work in the newly renovated warehouse.
- The Taxpayer was formed on December 23, 2004 to be the reporting entity. Because LLC 1 and LLC 2 are single member LLCs, the Taxpayer will be the only tax reporting entity and will be required to report all operations subject to the UBT.

LLC 1 acquired the Property. By agreements dated January 1, 2005, LLC 1 leased the Property to the IDA and the IDA leased the Property back to LLC 1. LLC 1 subleased the Property to LLC 2. All three entities, the Taxpayer, LLC 1, and LLC 2 entered into a guaranty agreement with the IDA.

As the operating company, LLC 2 will report the activity of the New Location on its books and records. LLC 2 will also be the employing entity, seeking to hire or lease at least 20 individuals to work in at the New Location under its own FEIN number. Several employees from other business operations of the Company will be relocated to at the New Location and become employees of LLC 2.

Like the businesses at the other locations, the New Location will generally function as a branch of the Company.

ISSUE

You have requested a ruling that the Taxpayer may apply to the Department of Finance to be certified to claim REAP benefits arising out of the business operations at the New Location despite the fact that, if considered on its own, it would not meet one of the requirements for an eligible business, that it be in operation for the twenty-four months immediately preceding the taxable year of its relocation.

CONCLUSION

Based on the facts presented, and on the basis of an analysis of Taxpayer's specific function within a larger business structure that has been in operation for more than the required twenty-four months, we conclude that the Taxpayer may apply to the Department of Finance to be certified to claim REAP benefits arising out of the business operations at the New Location.

DISCUSSION

REAP provides tax credits under the Unincorporated Business Tax and other business taxes to eligible businesses that relocate from outside the eligible area¹ to eligible premises located in the eligible area. Code section 22-621(j) provides that a relocation may consist of the transfer of pre-existing business operations to eligible premises or the establishment of new business operations at eligible premises. The eligible business must move at least one employee from premises located outside the eligible area, defined above, to eligible premises within the eligible area.

Code section 22-621(a) defines eligible business, in pertinent part, as follows:

“Eligible Business.” Any person subject to a tax imposed under [the UBT] that: (1) has been conducting substantial business operations at one or more business locations outside the eligible area for the twenty-four consecutive months immediately preceding the taxable year during which such eligible business relocates as defined in subdivision (j) of this section; and (2) on or after May twenty-seventh, nineteen hundred eighty-seven relocates as defined in subdivision (j) of this section all or part of such business operations;...

Code section 22-621(b) defines person as follows: “‘Person.’ Includes any individual, partnership, association, joint-stock company, corporation, estate or trust, limited liability company, and any combination of the foregoing.”

Thus, to be an “eligible business” to apply for REAP credits, a person must have conducted business outside the area for 24 months before the taxable year establishing the new business and at least one

¹ The eligible area is New York City with the exception of Manhattan south of 96th Street.

employee from another business location must work in the new location. To receive the credit, a business must apply and be certified by the Department of Finance Code section 22-621(b).

In this case, the Company has operated in the distribution of building materials and supplies to domestic wholesalers and retailers throughout the northeastern portion of the United States for well over 24 months. The New Location will continue in that business and will employ several employees from its other locations. The Taxpayer, however, is a new entity. You have asked us to rule that the Taxpayer is an eligible business that may apply for that certification; you have not asked us to rule on other matters related to receive the REAP credit, such as area or premises.

Employees at the New Location will be employed by LLC 2. The Taxpayer will be an “eligible business” to apply for the REAP credit if (i) the LLC 2 would be an “eligible business” to apply for the credit and (ii) if the Taxpayer can report the credits that may be claimed by LLC 2.

LLC 2 as an eligible business. To be an eligible business, a “person” must have conducted business outside the area for 24 months before the taxable year establishing the new business, and some employees from the other business locations must work in the new location. You have represented that the Company has been in the building and lumber supply business since 1979, that activity at that New Location will be in that building and lumber supply business, and that several employees from outside the eligible area will be relocated to work at the New Location as employees of LLC 2. For purposes of this ruling, we are assuming that the Company be an “eligible business” and could apply for the REAP certification.

LLC 2 is hiring employees to work at the New Location, and, because it was formed in November 2004, it cannot be an eligible business. The Company’s Shareholders own the Taxpayer, which in turn owns LLC 2; as a result the Company’s Shareholders are the sole beneficial owners of LLC 2. You have asked us to rule that, because the Company could apply for the REAP certification and its shareholders are the sole beneficial owner of LLC 2, LLC 2 can apply for certification.

Code section 22-621(b) defines person as including “any individual, partnership, association, joint-stock company, corporation, estate or trust, limited liability company, and any combination of the foregoing.” LLC 2 is a limited liability company and a person under that section. The plain language of Code section 22-621(b) refers to distinct legal entities and does not refer to entities with common beneficial ownership, and we have found no authority addressing whether the definition of a “person” includes other entities that share a common beneficial ownership. In the absence of other authority concerning the definition of person, a plain reading of the statute would not permit us to conclude that LLC 2 may apply for the REAP credit.

As a result, on the basis of the transaction’s form, LLC 2 would not be able to apply for REAP certification. You have asked us to rule that, despite that form, the substance of the transaction is such that LLC 2 should be treated as a branch of the Company and that LLC 2 should be able to apply for the credit on that basis.

Because a taxpayer selects the form of a transaction, it generally cannot disavow that form for tax purposes. See Commissioner v. National Alfalfa Dehydrating and Milling Co., 417 U.S. 134, 148-149 (1974); Sverdlow v. Bates, 283 A.D. 487, 491 (3rd Dept. 1954). Allowing taxpayers to rely on a

substance that is different from the form could present numerous problems; for example, the taxing authority could be faced with conflicting claims if different parties argued for different tax treatment for the same transaction. See, e.g., Comdisco, Inc. v. United States, 756 F.2d 569, 578 (7th Cir. 1985). For a taxpayer to rely on a transaction's substance rather than its form for tax purposes, the taxpayer must have a strong basis to do so, such as, offering substantial evidence of the transaction's substance, presenting a compelling reason why the particular form was selected, representing that parties to the transaction will report the transaction the same way, and showing that treating the transaction in accordance with its substance is consistent with the purpose of the law at issue. See, e.g., Comdisco, Inc. v. United States, *supra*; Illinois Power v. Commissioner, 87 T.C. 1417, 1434 (1986); Coleman v. Commissioner, 87 T.C. 178, 201-202 (1986), aff'd per curiam, 833 F.2d 303 (3rd Cir. 1987).

Applying those standards to this case, with regard to the substance of the transaction, the Company's Shareholders, through their 100 percent ownership of the Taxpayer, own 100 percent of LLC 2. They were responsible for acquiring and developing the New Location, arranging, planning, and implementing the business at the New Location, and working with the IDA. By virtue of their 100 percent ownership of LLC 2, the Company's Shareholders exercise control over all business, legal, and employment decisions of LLC 2 to the same extent as if LLC 2 were a branch of the Company. As a result, we conclude that you have offered substantial evidence that the substance of the transaction is that LLC 2 should be treated as a branch of the Company.

Second, the form of the transaction was selected in accordance with its arrangement with the IDA to obtain financing for the project. The IDA, a corporate governmental agency authorized and established under New York State and City laws to promote economic development in the City, agreed to provide certain tax and financial benefits to the Company, and the Company agreed to develop and operate the New Location, which included renovating and expanding a warehouse to 50,000 square feet. The form of the transaction, the three-entity structure involving the Taxpayer, LLC 1, and LLC 2, was selected in the context of the Company's arrangement with the IDA to help serve the IDA's public mission. As a result, the Taxpayer has presented a compelling reason why the particular form was adopted.

Third, you have represented that all the parties involved in the transaction will report the activities arising out of the New Location in the same way.

And fourth, REAP is designed to foster business development in certain areas of the City by encouraging businesses to "relocate" to those area. The relocation does not require that the business abandon an existing operation. In this case, the Company was primarily in the business of distributing of building materials and supplies to domestic wholesalers and retailers at various locations. The business at the New Location will similarly involve the distribution of building materials and supplies and will use some employees from the other locations. Though the entity that will be carrying on the business operations is new, there will be continuity with regard to both the nature of the related business and its ownership. As a result, the substance of the arrangement is a relocation for REAP purposes and treating the transaction in accordance with its substance is consistent with the purpose of the law at issue

Based on the facts presented, you have offered a strong basis to treat the transaction based on its substance rather than its form for these purposes. As a result, we conclude that LLC 2 is an eligible person for REAP purposes.

Taxpayer's eligibility to apply for REAP credits. LLC 2, the entity eligible to apply for REAP credits, is a single member Limited Liability Company treated as a disregarded entity for federal income tax purposes. In Finance Memorandum 99-1, the Department concluded that single owner entities that are treated as disregarded entities for federal income tax purposes will be similarly disregarded for New York City Tax purposes, including the UBT. As a result, for UBT purposes, the activities of LLC 2 are treated as activities of the Taxpayer, and the Taxpayer can claim REAP benefits that result from the activities of LLC 2.

Summary. You have requested a ruling that the Taxpayer may apply for REAP benefits arising out of employment at the New Location. Based on the information submitted, we have concluded that the substance of the transaction is that LLC 2 is merely a branch of the Company, and that that substance should control for purposes of determining the eligibility for REAP benefits. Second, because LLC 2 is a disregarded entity for federal income tax purposes, any REAP benefits will be available to the Taxpayer. As a result, we concluded that the Taxpayer may apply for REAP benefits arising out of the Taxpayer's business operations at the New Location.

* * *

The Department of Finance reserves the right to verify the information submitted.

Sincerely,

Dara Jaffee
Assistant Commissioner for Legal Affairs

LED: ld