

# New York Appellate Court Rules in Favor of S Corporation Shareholder Entitlement to New York QEZE Tax Credits

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In a pair of decisions, a New York State appellate court has annulled decisions of the New York State Tax Appeals Tribunal that reduced certain tax credits available to the individual shareholders of their S corporation. *Matter of Herman Schreiber et. al. v. N.Y.S. Tax Appeals Trib., et. al.*, Case No. 535976 (3d Dep't 2023); *Matter of Sam Goldstein et. al. v. N.Y.S. Tax Appeals Trib., et. al.*, Case No. 535980 (3d Dep't 2023).

**Facts:** Messrs. Schreiber and Goldstein ("Shareholders") each own 50 percent, directly and through trusts, of the stock of B&H Foto & Electronic Corporation ("B&H"), a Manhattan-based S corporation retailer that principally sells electronics and photography equipment including through a significant amount of mail order and online orders shipped outside New York State. B&H is certified as a New York "qualified empire zone enterprise" ("QEZE"), entitling shareholders to claim the credits on their New York State income tax returns.

Shareholders filed New York State resident income tax returns reporting their respective shares of income from B&H, as well as their share of any QEZE tax credits. In part, the shareholder's QEZE credit is based on the ratio of the shareholder's share of S corporation income allocated within the State to the shareholder's New York adjusted gross income.

As New York State residents, Shareholders calculated their QEZE credits based on all of B&H's taxable income, including income from sales shipped outside the State. Following an audit, the Division of Taxation ("Division") reduced the credit by multiplying it by B&H's business allocation percentage ("BAP") of approximately 18 percent. The Tax Appeals Tribunal, relying on a court decision authorizing application of an S corporation's BAP, upheld the Division's use of B&H's BAP to reduce the Shareholders' QEZE credits. This judicial appeal by the taxpayers followed.

**Decision:** The Appellate Division held that the Tax Appeals Tribunal erred in concluding that the S corporation's BAP must be applied to the Shareholders' QEZE credits in all cases. The court found that use of B&H's BAP resulted in a drastic reduction of Shareholders' QEZE credit which would lead to an irrational result in the case. The court considered it significant that the tax law limits the QEZE credit to the "shareholder's *income* from the S corporation allocated within the state," rather than to "*sales* with a destination point within New York State." This suggests that the court found that the Shareholders, as New York State residents, reported all of their income from B&H to New York.

This obviated the need to limit their QEZE credits based on B&H's BAP and demonstrated unambiguous entitlement to the full credit. The court found that restricting the QEZE credit was contrary to the statutory purpose of the QEZE economic development program. The court annulled the Tribunal decision, authorizing a full QEZE credit and refund to the Shareholders

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