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This Week in State Tax (TWIST)

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New York: Wine Producer is a Qualified New York Manufacturer

An Administrative Law Judge (ALJ) for the New York Division of Tax Appeals recently concluded that a taxpayer engaged in viticulture, which is the cultivation of grapevines for the purpose of growing and producing grapes, was a "qualified New York manufacturer or QNYM" for the tax years at issue (2016-2019). The taxpayer used certain of its grapes to make wine and sold the remainder to unrelated winemakers. Under New York law for the relevant period, corporate taxpayers paid tax on the highest of three alternative bases. Each base provided some benefit to a QNYM; the rate imposed on the business income base was zero for the years at issue. To be considered a QNYM, the taxpayer had to establish that (1) it was a manufacturer principally engaged in the production of goods by various activities, including viticulture; (2) it had property in New York the adjusted basis of which for federal income tax purposes was at least equal to $1 million, and (3) that the property was "principally used" by the taxpayer in the production of goods by viticulture. The taxpayer met the first two requirements; the outstanding issue was whether the taxpayer "used" its property in New York when it contracted with an unrelated land-management contractor to perform the work at the New York vineyard in accordance with the taxpayer's objectives and requirements. The Division asserted that because the taxpayer had no employees in New York, it could not have "used" its property in New York, as required to be a QNYM.

The ALJ rejected this position for several reasons. First, authorities addressing the Investment Tax Credit, which also had a "use" requirement, supported a finding that "use" by a subcontractor (short of a lease) does not negate the property owner's right to the credit. Further, nothing in the statute required a taxpayer to have employees in the state. This contrasted with another statutory test for QNYM status that specifically required 2,500 manufacturing employees in the state. The ALJ noted that, in the absence of any employee requirement in the QNYM provisions, the Division was attempting to force one into the statute. The ALJ also determined that the ordinary meaning of "use" contemplated use by a third party. Regardless of who is subcontracted to perform day-to-day labor at the vineyard, the ALJ observed that the taxpayer employed its grapevines for a purpose and put the grapevines into service. The ALJ also concluded that the taxpayer "used" the property at the vineyard during the 2016 tax year, even though it acquired the vineyard on December 15, 2016. The Division had argued that this time was during the "dormancy period" in the growing of grapes and so there was not much manual work to perform. The ALJ rejected this view, noting that there was no provision in the law requiring a taxpayer to own property for a specific period to qualify as a QNYM. Further, the natural components of viticulture could not be disregarded, and they occurred throughout the entire year, including during dormancy. The Division offered no expertise or other evidence to contradict this fact. As such, the ALJ concluded that the taxpayer was a QNYM for the 2016-2019 tax years. Please contact Russ Levitt with questions of *Matter of E&J Gallo Winery*.

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