NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	DETERMINATION
Of	:	TAT(H)20-32(UB)
A&E Television Networks, LLC	:	

Kalish, A.L.J.:

On November 13, 2020, Petitioner, A&E Television Networks, LLC (AETN), filed a petition for a redetermination of a deficiency (Petition) of New York City (City) Unincorporated Business Tax (UBT) under Title 11, Chapter 5, of the City Administrative Code (Administrative Code), for its tax years ended December 31, 2012, September 30, 2013 and September 30, 2014. The deficiency was asserted in a Notice of Determination issued by the Commissioner of the Department of Finance (Department), dated March 29, 2018 (Notice). The Notice was previously affirmed by a decision of the Department's Conciliation Bureau, dated August 28, 2020.

On August 17, 2021, Respondent, the Department, filed its Answer to the Petition.

On July 14, 2023, the parties, having agreed pursuant to § 1-09[f] of the City Tax Appeals Tribunal (Tribunal) Rules of Practice and Procedure (20 RCNY) to have this case determined on submission without a need for an appearance at a hearing, submitted a stipulation of facts, including exhibits (Stipulation). On April 5, 2024, the parties filed an amended version of the Stipulation (Amended Stipulation).

Petitioner filed an opening brief on September 22, 2023. Respondent filed an answering brief on November 3, 2023. Petitioner filed a reply brief on December 12, 2023. Respondent filed a reply brief on January 8, 2024.

Petitioner was represented by Michael Goldsmith, Esq., and Angela Dimos, Esq., each of Ernst & Young LLP, and Jeffrey A. Friedman, Esq., and Ted W. Friedman, Esq., each of Eversheds Sutherland (US) LLP. Respondent was represented by Adam Dembrow, Esq., Assistant Corporation Counsel, of the City Law Department.

This case was originally assigned on August 26, 2021 to former Administrative Law Judge (ALJ) Alexander Chu-Fong. The case was reassigned on September 28, 2021 to former ALJ Sandra Rodriguez-Diaz. The case was subsequently reassigned to the undersigned on September 25, 2023.

ISSUE

Whether, in the context of the introductory paragraph of City Administrative Code § 11-507, and for purposes of determining an item's deductibility under the City UBT, the phrase "directly connected with or incurred in the conduct of the business" imposes a discrete requirement that should be interpreted without reference to the phrase "allowable for federal income tax purposes for the taxable year."

FINDINGS OF FACT

The facts as presented in the Amended Stipulation, and the exhibits attached thereto, have been accepted. The relevant facts, which have been renumbered and modified without impact to substance, appear below.

1. AETN is a media company that owns a portfolio of non-fiction and entertainment-based television brands.

2. AETN is involved in the creation, acquisition and distribution of television programming and other content that is licensed to various distributors with worldwide audiences.

3. AETN is a limited liability company organized under the laws of Delaware and classified as a partnership for federal income tax purposes.

4. AETN is subject to the City UBT.

5. Prior to 2009, AETN was owned as follows: 25% by NBC-A&E Holding, Inc. (NBCUniversal); 37.5% by Hearst Communications, Inc. (Hearst Communications); and 37.5% by Disney/ABC International Television, Inc. (Disney/ABC TV).

6. In 2009, as a result of AETN's acquisition of Lifetime Entertainment Services (Acquisition), NBCUniversal's equity in AETN was reduced from 25% to 15.8%; the Hearst equity in AETN was increased from 37.5% to 42.1%, and was owned as follows: 23.7% by Hearst Communications, 6.1% by Hearst LT, Inc. and 12.3% by Hearst Holdings, Inc. (collectively, Hearst Partners); the Disney equity in AETN was increased from 37.5% to 42.1% and was owned as follows: 36% by Disney/ABC TV and

6.1% by Cable LT Holdings, Inc. (collectively, the Disney-ABC Television Partners). NBCUniversal, the Hearst Partners and the Disney-ABC Television Partners are collectively referred to hereinafter as the "Partners."

7. In connection with the Acquisition, the Partners entered into a Second Amended and Restated LLC Agreement, which granted NBCUniversal the option to require AETN to redeem a portion of NBCUniversal's equity in AETN (NBC-A&E Put Option).

8. After the Acquisition and in connection with NBCUniversal LLC holding the NBC-A&E Put Option, the Partners agreed that AETN would redeem all of NBCUniversal's equity in AETN in August of 2012 in exchange for $3.025 billion cash (Redemption).

9. AETN financed the Redemption with approximately $2.45 billion of debt from unrelated parties (Redemption Debt) and $600 million of cash contributions from the Hearst Partners and the Disney-ABC Television Partners, each of which owned 50% of AETN directly following the Redemption.

10. AETN timely filed City UBT returns (Forms NYC-204) with the Department and federal returns of partnership income (Forms 1065) with the Internal Revenue Service (IRS) for the tax years ended December 31, 2012, September 30, 2013 and September 30, 2014 (Audit Period).

11. AETN reported the Redemption as a distribution on its federal returns of partnership income and designated the interest expense attributable to the Redemption Debt (Redemption Debt Interest Expense) as a deductible expense

for the Audit Period.

12. AETN allocated the Redemption Debt proceeds and associated Redemption Debt Interest Expense among its trade or business assets under Internal Revenue Code (IRC) § 163, Treasury Regulation § 1-1.63-8T, and IRS Notice 89-35.

13. AETN included the Redemption Debt Interest Expense in its entirety as a deductible expense for federal income tax purposes.

14. The IRS audited AETN's federal return of partnership income for the tax year ended December 31, 2012 (2012 Audit).

15. As part of its 2012 Audit, the IRS issued "Information Document Request" No. 3 dated May 31, 2018 (IDR 3) and "Information Document Request" No. 7 dated August 6, 2018 (IDR 7). IDR3 and IDR 7 each specifically requested information about AETN's interest expense deduction.

16. IDR 7 included a request for a copy of the loan agreement for the Redemption Debt as well as "copies of invoices and other substantiation verifying IRC § 162 – business purpose" for the Redemption Debt.

17. The IRS sent AETN a Notice of Proposed Adjustment dated July 10, 2019 (Form 5), which proposed no adjustment to AETN's reported interest expense deduction for the 2012 Audit.

18. The IRS settled the 2012 Audit with an "Agreement for Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts" (Form 870-PT), which was signed by the IRS on February 20, 2020.

19. AETN received the Form 870-PT on February 16, 2021.

20. Although certain adjustments were made to AETN's federal return of partnership income pursuant to Form 870-PT, the IRS made no adjustment to AETN's reported interest expense deduction as a result of the 2012 Audit.

21. AETN filed an amended City UBT return dated March 3, 2021, for the tax year ended December 31, 2012, based on the Form 870-PT.

22. The IRS did not audit AETN's federal returns of partnership income for the tax years ended September 30, 2013 or September 30, 2014.

23. The Department conducted an audit of AETN's originally filed UBT returns for the Audit Period, which ultimately resulted in the issuance of the Notice.

24. The Notice asserted a UBT liability against Petitioner.

25. Under "Explanation of Adjustment(s)," the Notice solely states as follows: "Interest expense for debt finances distribution was adjusted by 94% as it was deemed not business related."

POSITIONS OF THE PARTIES

Petitioner asserts that when a deduction is allowable to a UBT taxpayer for federal purposes, it is allowable for City UBT purposes, unless an enumerated statutory modification applies.

Specifically, Petitioner asserts that because (i) the Redemption Debt Interest Expense was deductible for federal income tax purposes, and (ii) none of the enumerated modifications of

City Administrative Code § 11-507 apply, Petitioner was required under the plain language of the statute to treat the Redemption Debt Interest Expense as a deduction for City UBT purposes.

Respondent does not dispute (i) that Petitioner was allowed to deduct the Redemption Debt Interest Expense for federal income tax purposes, or (ii) that none of the enumerated modifications apply to the Redemption Debt Interest Expense.

However, Respondent asserts that the requirement imposed by the phrase "directly connected with or incurred in the conduct of the business," which is included in the introductory paragraph of Administrative Code § 11-507, should be interpreted without reference to the directly subsequent phrase, "which is allowable for federal income tax purposes." In Respondent's view, the plain language of the statute supports such an interpretation.

Respondent further argues, without reference to the federal standard, that the Redemption Debt Interest Expense was not directly connected with or incurred in the conduct of the business of Petitioner. Therefore, in Respondent's view, the Redemption Debt Interest Expense was not an allowable deduction for City UBT purposes.

Petitioner, in turn, asserts that Respondent misconstrues the plain language of Administrative Code § 11-507. Petitioner argues that "[b]y failing to understand the standard that must be met for claiming a deduction for federal income tax purposes, the Department has manufactured an additional 'requirement' in NYC Administrative Code § 11-507 that does not exist." In Petitioner's

view, the "federal standard is virtually identical to the language used in Administrative Code § 11-507."

Petitioner buttresses their position by stating that "the exact argument the Department has advanced in this case has been expressly rejected by the New York State Tax Appeals Tribunal [in *the Matter of New York Yankees Partnership*[1]]" and that "the Department's interpretation of . . . Administrative Code § 11-507 conflicts with the legislative history of the UBT and the express intention for the UBT to conform to the federal Internal Revenue Code."

Petitioner further asserts that, even if Respondent's interpretation of Administrative Code § 11-507 is correct, Petitioner is still entitled to the deduction as the Redemption Debt Interest Expense was directly connected with or incurred in the conduct of Petitioner's business.

Respondent, in further turn, claims that its interpretation of Administrative Code § 11-507 is consistent with the language of the statute and well-established principles of statutory construction. Respondent argues that the New York State Tax Appeals Tribunal's decision in *New York Yankees* is not binding on the present case and that Respondent's interpretation of Administrative Code § 11-507 does not conflict with the legislative history of the statute.

[1] DTA No. 800263 [NYS Tax Appeals Tribunal, 1991].

CONCLUSIONS OF LAW

This case concerns the statutory construction of a provision under the City's UBT that provides for deductions from taxable income. A statute authorizing a deduction should generally be construed against the taxpayer (*See Matter of Grace v New York State Tax Commn.*, 37 NY2d 193, 196-197 [1975], discussing the rules of statutory construction as applied to exemptions and deductions). To prove entitlement to a deduction, which is "a particularized species of exemption" *(See Matter of Grace* at 197*)*, the "taxpayer must establish that its interpretation of the statute is not only plausible, but also that it is the only reasonable construction" *(Moran Towing & Transp. Co. v. New York State Tax Comm'n*, 72 NY2d 166, 173 [1988]. However, "the interpretation should not be so narrow and literal as to defeat [the statute's] settled purpose" (*Matter of Grace* at 196, citing *Engle v Talarico*, 33 NY2d 237, 240 [1973], *People ex rel. Watchtower Bible & Tract Soc. v Haring*, 8 NY2d 350, 358 [1960] and *People ex rel. Mizpah Lodge v Burke*, 228 NY 245, 247-248 [1920]).

The City UBT is imposed "on the unincorporated business taxable income of every unincorporated business wholly or partly carried on within the [C]ity" (Administrative Code § 11-503.a). The unincorporated business taxable income of an unincorporated business is defined as "the excess of its unincorporated business gross income over its unincorporated business deductions," minus certain deductions not subject to allocation and statutory exemptions (Administrative Code § 11-505).

"Unincorporated business deductions" are "the items of loss and deduction directly connected with or incurred in the conduct of the business, which are allowable for federal income tax purposes for the taxable year" subject to enumerated modifications (Administrative Code § 11-507).[2]

The applicable federal income tax standard for allowable deductions, as set forth under Treasury Regulation § 1.162-1.a, includes language that is similar to the relevant portion of the introductory paragraph of Administrative Code § 11-507. Treasury Regulation § 1.162-1.a provides:

> "Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than [IRC] section 162."

The primary dispute in this case is whether the phrase "directly connected with or incurred in the conduct of the business" imposes a discrete requirement that should be interpreted without reference to the phrase "which are allowable for federal income tax purposes for the taxable year."

Both parties assert that the plain language of the statute unambiguously supports their interpretation. However, the parties' respective interpretations are diametrically opposed.

[2] It is undisputed that none of the enumeration modifications apply to the Redemption Debt Interest Expense.

In Petitioner's view, the phrase "which are allowable for federal income tax purposes for the taxable year" (Federally Allowable Phrase) mandates that the City looks to the federal standard for determining whether a particular loss or deduction was "directly connected with or incurred in the conduct of the business" (Directly Connected With Phrase; together, with the Federally Allowable Phrase, "Introductory Phrases").

In Respondent's view, each of the Directly Connected With Phrase and the Federally Allowable Phrase impose a separate, and discrete, requirement. In other words, under Respondent's view, an initial inquiry of whether an item of loss or deduction is directly connected with or incurred in the conduct of the business may be undertaken by the City without reference to the federal standard. Then, if the first requirement is satisfied, the second inquiry is whether the expense was allowable for federal income tax purposes.[3]

The Federally Allowable Phrase may be read as an appositive expression, which explains or clarifies the phrase prior to the comma. Such an interpretation would support Petitioner's position. However, the Federally Allowable Phrase may also be read as the second part of a compound sentence, which supports Respondent's position.[4] Therefore, the provision, at first glance, appears to be ambiguous.

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[3] Notably, the Department has the authority to separately determine the applicability of the federal standard, regardless of a determination by the IRS. (Rules of the City of New York Unincorporated Business Tax (19 RCNY) (UBT Rules) 28-20[d]).

[4] A compound sentence generally includes a coordinating conjunctive, which is notably absent from the provision. However, the provision may be interpreted as a compound sentence even if the interpretation is not grammatically correct, as proper construction is given "without reference to the accurate grammatical

Nonetheless, when interpreting a statute, "meaning and effect should be given to all its language, if possible, and words are not to be rejected as superfluous when it is practicable to give to each a distinct and separate meaning" (McKinney's Statutes § 231; *See also*, *Matter of Mestecky v City of NY*, 30 NY3d 239, 243 [2017] and *People ex rel. Schneiderman v Sprint Nextel Corp.*, 26 NY3d 98, 110 [2015]).

Respondent asserts that if the Federally Allowable Phrase has the same meaning as the Directly Connected With Phrase, then the former would render the latter superfluous, essentially removing meaning from the words of the phrase. However, Petitioner's interpretation of the provision does not require that the phrases be read to share the same meaning. Rather, the interpretation requires that the phrases are read, together, to apply the federal standard when determining whether an item is directly connected with or incurred in the conduct of the taxpayer's business. Meaning and import is thus attributed to the Directly Connected With Phrase, even if, as a practical matter and absent the application of an enumerated modification, all deductions which are allowable for federal purposes are also allowable for City UBT purposes.

Moreover, the "preference for avoiding surplusage constructions is not absolute" (*Lamie v U.S. Tr.,* 540 US 526, 536 [2004], citing *Chickasaw Nation v United States*, 534 US 84, 94

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construction of words, phrases, and sentences" (McKinney's Statutes § 251). Moreover, the Department's regulations rephrase the provision at issue, in part by substituting the word "and," a coordinating conjunctive, for the comma between the Introductory Phrases (*See* UBT Rule 28-06[a]).

[2001]), and ultimately, the goal of statutory construction is to discern the intent of the legislature when enacting the relevant provision (*Sprint Communications Co., L.P., v City of N.Y. Department of Finance,* 152 AD3d 184, 189 [1st Dept 2017]*; Chickasaw Nation*, 534 US at 94; McKinney's Statutes § 92). Therefore, it is appropriate to consider the legislative history of the applicable phrases and the UBT generally (*See Matter of LAZARD FRERES & CO.*, TAT (E) 93-107 (UB) [NYC Tax Appeals Tribunal, Appellate Division, 1996], discussing the legislative history of the UBT for the purpose of statutory construction; *See also*, *Matter of DCH Auto v Town of Mamaroneck*, 38 NY 278, 292 [2022], and *Roberts v Tishman Speyer Properties, L.P.*, 13 NY3d 270, 286 [2009], citing *Majewski v Broadalbin-Perth Cent. Sch. Dist.,* 91 NY2d 577, 583 [1998]), each discussing the proper use of legislative history when construing the meaning of a statute).

The City UBT is patterned after the former State UBT (*See Shapiro v New York*, 32 NY2d 96, 100 [1973], discussing the history of the City UBT). The State UBT was enacted in 1935 (L 1935, ch 33). At the time of the 1935 enactment, unincorporated business tax deductions were required by statute to be "directly connected with or incurred in the conduct of the unincorporated business." However, until 1960, the statute did not explicitly reference the federal standard. In 1960, the State UBT definition of unincorporated business deductions was modified, in part by adding the Federally Allowable Phrase (L 1960, ch 564). The relevant portion of the post-1960 reform State UBT definition of

unincorporated business deduction is identical to that of the City UBT, which was subsequently enacted in 1966 (L 1966, ch 772).[5]

The 1960 reform was the result of the 1959 Wise-Calli amendment to the State Constitution, which authorized the State Legislature to define "the income on, in respect to or by which [income taxes] . . . are imposed or measured, by reference to any provision of the laws of the United States" (NY Const, art III, § 22; *See also*, Governor's Mem approving L 1960, ch 564, 1960 McKinney's Sess Laws of NY at 2026-2027). The governor's memorandum that accompanied the 1960 reform stated that the reform "brings substantial conformity with federal provisions to our law imposing the tax on unincorporated business income" (Governor's Mem approving L 1960, ch 564, 1960 McKinney's Sess Laws of NY at 2027).

A contemporaneous memorandum from the New York State Department of Taxation and Finance in support of the provisions in the 1960 reform also provides a window into the intention of the legislature.[6] The memorandum states "[t]his bill revises the unincorporated business tax and bases it on the same business income and deductions as are used for federal income tax purposes,

[5] The City's UBT provision governing deductions was codified at the time of enactment in NYC Administrative Code § S46-6.0 and was subsequently renumbered to NYC Administrative Code § 11-507, which is the statute at issue in this case.

[6] Respondent argues that the memorandum of the Department of Taxation and Finance (DTF) is not indicative of legislative intent, as DTF is not a legislature. However, the memorandum was included in the relevant legislative bill jacket. Similar memorandums, included in legislative bill jackets, have historically been considered by the Tribunal when determining legislative intent. See *Matter of American Airlines, Inc.*, TAT (E) 05-29 (HO) [NYC Tax Appeals Tribunal, Appeals Division, 2009], and *Matter of Seligman Growth Fund, Inc. (F/K/A National Investors Corp.)*, TAT (E) 94-474 (GC) [NYC Tax Appeals Tribunal, Appeals Division, 2000].

with specified modifications. It incorporates by reference the definition of gross income and business deductions contained in the Internal Revenue Code" (Mem of Dept of Taxation and Finance, Bill Jacket, L 1960, ch 564 at 16).

Thus, when considered in the context of the legislative history, it is clear that Petitioner's interpretation of the Introductory Phrases is the only reasonable construction of the statute, and that the Federally Allowable Phrase was included in the definition of unincorporated business deductions to conform the standard of the Directly Connected With Phrase to the applicable standard for federal income tax purposes.

Such interpretation is consistent with prior New York State Tax Appeals Tribunal and New York State Court opinions.

As discussed above, the City UBT was patterned after the former State UBT, and the specific City provision at issue in this case is identical to the corresponding provision that was included in the former State UBT law and analyzed in *New York Yankees.* In that case, DTF made a similar argument to that which Respondent is making in the present case. DTF argued that

> "for an unincorporated business deduction allowance, such deduction must be directly connected with or incurred in the conduct of the business. The Division argues that the payments in question did not pertain to the conduct of petitioner's business, i.e., the operation of a baseball team, but, as liquidation payments, were a transaction between the members of the partnership. Thus, the Division argues that the payments were not directly connected with or incurred in the

conduct of the business and did not qualify for the deduction."

The State Tribunal concluded that

"[f]ederal law . . . clearly provides the partnership with a deduction for the payments . . . . Therefore, since [the] payments . . . are deductible for federal purposes, then the payments . . . are deductible for State purposes, provided that they do not fall within any of the enumerated modifications . . . ."

Here, Respondent does not dispute that the Redemption Debt Interest Expense was an allowable deduction under federal law. Therefore, under the reasoning of *New York Yankees*, unless an enumerated modification applies, the Redemption Debt Interest Expense is deductible for City UBT purposes.[7] As none of the enumeration modifications apply, the Redemption Debt Interest Expense payment is deductible for City UBT purposes.

Respondent cites *Matter of Horowitz v New York City Tax Appeals Trib.,* 41 AD3d 101, 102 [1st Dept 2007], for the proposition that payments may be deductible for federal income tax purposes but nonetheless not be deductible for City UBT purposes. However, in *Horowitz,* the majority opinion did not include any analysis as to whether the expenses at issue were "directly connected with or

[7] Respondent argues in their reply brief that *New York Yankees* is not binding on the present case because the issue in *New York Yankees* was "whether payments to a partner [for the liquidation of the partner's interest] are deductible," while the present issue is "whether interest on a loan to make such payments is directly connected to the business of the partnership . . . ." However, the classification of deduction is irrelevant to the analysis of the Introductory Phrases. Therefore, Respondent assertion that *New York Yankees* is not binding on the present case is misguided.

incurred in the conduct of the business." Rather, the payments were held nondeductible for City UBT purposes as the result of the application of an enumerated modification. Therefore, the majority's holding in *Horowitz* does not conflict with the analysis in *New York Yankees* and is irrelevant to the issue in this case.

Of note, however, is the analysis included in the dissenting opinion by Judge McGuire in *Horowitz.* While the dissent was based on a differing view from the majority with respect to the applicability of the relevant enumerated modification, the dissenting opinion provided, as background and in harmony with the majority opinion, a clear statement that when an expense is allowable to a City UBT taxpayer for federal purposes, the expense is considered "directly connected with or incurred in the conduct" of the taxpayer's business:

> "Albeit begrudgingly, respondents concede that the deductions are allowable under federal law, and thus respondents necessarily concede as well that they are 'directly connected with or incurred in the conduct' of petitioner's [business]" (*Horowitz,* 41 AD3d at 103, [McGuire, J., dissenting]).

In this case, Respondent likewise concedes that the deduction for the Redemption Debt Interest Expense was allowable under federal law, and thus, Respondent necessarily concedes that the Redemption Debt Interest Expense was "directly connected with or incurred in the conduct" of Petitioner's business.

ACCORDINGLY, IT IS CONCLUDATED THAT in the context of the introductory paragraph of Administrative Code § 11-507, and for purposes of determining an item's deductibility under the Unincorporated Business Tax, the phrase "directly connected with or incurred in the conduct of the business" does not impose a discrete requirement that should be interpreted without reference to the phrase "allowable for federal income tax purposes for the taxable year." Rather, a determination of whether a particular item is "directly connected with or incurred in the conduct of the business" must be made under the applicable federal standard. As Respondent concedes that the Redemption Debt Interest Expense was allowable for federal income tax purposes, and none of the enumerated modifications of Administrative Code § 11-507 apply, the Redemption Debt Interest Expense is an allowable deduction for City UBT purposes. The Petition is therefore granted, and the Notice is cancelled.

DATED: July 2, 2024
New York, New York

/s/
Jarrett S. Kalish
Administrative Law Judge