

PART Rev 303 ADDITIONS AND DEDUCTIONS MADE TO GROSS BUSINESS PROFITS

Readopt with amendments Rev 303.01, effective 8-25-06 (Doc #8709), to read as follows:

Rev 303.01 Compensation *Deduction* for *Actual* Personal Services of Proprietor, Partner or Member.

(a) For purposes of this ~~chapter~~ *section*, the following definitions shall apply:

(1) *“Actual personal services” means the services performed by a natural person, who is a proprietor, partner or member of an unincorporated business organization, that are directly related to the operation of the unincorporated business organization taking the compensation deduction, but not in any capacity for another business organization;*

~~(2) “Amounts which that are reasonable and fairly attributable to the actual personal services of the proprietor, partner or member” means the amount as would be allowed using the standards set forth in section 162(a)(1) of the United States Internal Revenue Code, as amended, and Treasury Regulations, administrative rulings, and judicial cases interpreting such provision that business organizations of similar size, volume and complexity compensate employees with similar responsibility, devotion of time, education and experience as the proprietor, partner or member actually rendering services. The term does not include amounts that are fairly attributable to a return on business assets and amounts that are fairly attributable to a return on the labor of non-owner employees;~~

(3) *“Business activity” means “business activity” as defined in RSA 77-A:1, XII;*

~~(24) “Fairly attributable to a return on business assets” means the income stream related to the use of business assets defined in RSA 77-A:1, XI, but not the services of maintaining those assets~~ *“Capital business asset” for purposes of determining the amount of the addition to the fair and reasonable compensation deduction allowable under RSA 77-A:4, III(a) means a “capital asset” as defined in section 1221(a) of the United States Internal Revenue Code, as amended, provided that the capital business asset shall be used by the unincorporated business organization to conduct business activity;*

(5) *“Unincorporated business organization” means a proprietorship, partnership, or limited liability company taxed as a proprietorship or partnership for federal income tax purposes;*

(6) *“Department” means the department of revenue administration;*

(7) *“Earned income” includes the following:*

*a. Net profit or loss from federal form 1040, schedule C;*

*b. Net farm profit or loss from federal form 1040, schedule F;*

*c. Ordinary income or loss from trade or business activities from federal form 1065, schedule K-1;*

*d. Guaranteed payments to a partner or member from federal form 1065, schedule K-1; and*

*e. Income, expenses or losses from business activities in the regular trade or business of the partnership or limited liability company taxed as partnership for federal tax purposes that are specifically allocated to the individual partner or member;*

~~(3)(8) “Fairly attributable to a return on the labor of non-owner employees” means the value to the business organization of its employees generally measured by the income to the business brought about by the efforts of non-owner employees over and above the costs to the organization for those employees including supervisory, training and overhead costs incurred by the business organization~~ **“Gross selling price as commissions on the sale of business assets” for purposes of determining the amount of the addition to the fair and reasonable compensation deduction allowable under RSA 77-A:4, III(a) means the amount received in exchange for the sale or other disposition of a capital business asset measured by the sum of:**

*a. Money received;*

*b. Indebtedness assumed by the buyer or transferee; and*

*c. The fair market value of any property, other than money, received in exchange for the capital business asset;*

~~(4)(9) “Actually renders personal services” means the services performed by the proprietor, partner or member of the business organization directly related to the operation of the business organization, but not in the capacity of an employee, owner, partner or member of another business organization~~ **“Natural person” means a human being, as well as a trustee of a grantor trust not recognized as a business organization; and**

**(10) “Total compensation” means the sum of compensation, as defined in Rev 301.09, fringe benefits, as defined in Rev 301.15, and any other form of remuneration for all proprietors, partners or members rendering actual personal services to the unincorporated business organization.**

~~(b) A Compensation deduction shall be available to a proprietor, partner, or member of a limited liability company taxed as a proprietorship or partnership for federal income tax purposes~~ **an unincorporated business organization for the total compensation that is reasonable and fairly attributable to its proprietors, partners or members who:**

~~(1) Is a natural person; and~~

~~(2) render~~ **Actually renders actual** personal services to the **unincorporated** business organization.

~~(c) Compensation~~ **The compensation deduction shall be determined for each proprietor, partner or member who rendered actual personal services to the unincorporated business organization and shall be allowed for amounts which are that would be allowable as reasonable under Internal Revenue Code section 162(a)(1), as amended from time to time, Treasury Regulation section 1.162-7, administrative rulings and judicial cases interpreting Internal Revenue Code section 162(a)(1). Based on existing authority, such deduction includes**

*amounts as would ordinarily be paid for like services by like business organizations under like circumstances existing at the date when the services were performed and by weighing the following factors derived from judicial cases interpreting Internal Revenue Code section 162(a)(1), to the extent applicable to the unincorporated business organization:*

- (1) ~~Reasonable and fairly attributable to the personal services of the proprietor, partner or member pursuant to RSA 77 A:4, III(a); and~~ *The nature, extent and scope of the proprietor, partner or member's work in the unincorporated business organization, which may include the position, time devoted, education or skill required, and duties performed;*
- (2) ~~Not in excess of the maximum deduction allowable pursuant to RSA 77 A:4, III(b).—~~*The size, volume and complexity of the unincorporated business organization when compared to similar business organizations in the same industry using comparative data such as but not limited to the number of employees, sales, net income, capital value, and total assets;*
- (3) *The compensation paid by similar business organizations in the same industry to employees having similar duties and responsibilities as the proprietor, partner or member using comparative compensation data from industry statistics and publications, such as but not limited to (i) the Almanac of Business and Industrial Financial Ratios published by CCH, Inc., (ii) the Occupational Outlook Handbook published by the U.S. Department of Labor, Bureau of Labor Statistics, available at [www.bls.gov](http://www.bls.gov), and (iii) the New Hampshire Wages and Benefits published by the New Hampshire Department of Employment Security, available at [www.nhes.state.nh.us](http://www.nhes.state.nh.us);*
- (4) *The general economic conditions related to the unincorporated business organization, as general economic conditions may affect a business organization's performance and indicate the extent, if any, of the proprietor, partner or member's effect on the company. For example, adverse economic conditions tend to show that a proprietor, partner or member's skill was important to an unincorporated business organization that grew during the bad years;*
- (5) *The unincorporated business organization's salary policies, either in writing or otherwise, for employees concerning salary determinations, salary increases, bonus payments, when bonuses are paid, and to whom bonuses are paid, as well as the length of time such policies have been in place or when the business organization adopted such policy. For example, if the unincorporated business organization has management positions for non-owner employees and the salaries and bonuses paid to the proprietor, partner or member are determined pursuant to a policy in a similar manner as the managers, who are non-owner employees, this shall weigh in favor of the compensation deduction being allowed as reasonable; in addition, salary policies that have been in place for significant periods of time shall weigh in favor of the compensation deduction being allowed as reasonable, if the compensation deduction was determined in accordance with the long-standing salary policy;*

- (6) *Whether the compensation deduction taken in prior years was insufficient and whether the amount of the current year's compensation deduction was intended as compensation for the prior period. For example, if the unincorporated business organization was unable to deduct a fair and reasonable compensation for a proprietor, partner or member in prior years due to a lack of income because it was a start-up company, it shall weigh in favor of the compensation deduction being allowed as reasonable so long as the unincorporated business organization can show that the current year's compensation deduction was intended to compensate the proprietor, partner or member for the prior underpayment or lack of payment;*
- (7) *Any compensation analysis performed by the unincorporated business organization prior to claiming the compensation deduction. If the unincorporated business organization documents the compensation analysis it used to determine whether its compensation deduction is reasonable prior to filing its return, the documented analysis shall weigh in favor of the compensation deduction being allowed as reasonable; and*
- (8) *Whether the compensation deduction includes any amounts that are attributable to an owner's return on investment of capital in the unincorporated business organization. Such amounts shall weigh against the compensation deduction being allowed as reasonable. Similarly, if after the compensation deduction is taken, taxable business profits remain that are either paid to the proprietor, partner or member as a distribution or retained in the unincorporated business organization, this shall weigh in favor of the compensation deduction being allowed as reasonable.*

*(d) The amount determined in (c) above shall not exceed the amount reported as earned income, as defined in Rev 303.01(a)(7), on the federal income tax returns of the proprietor, partner, or member, but may also include:*

- (1) An amount not to exceed net income from rental properties from federal form 1040, schedule E, federal form 8825 and federal form 4835; and*
- (2) An amount not to exceed 15 percent of the gross selling price as commissions on the sale of capital business assets. If the proprietor, partner or member acted as the broker or agent for the sale of capital business assets, the following shall apply:*
  - a. If no other broker or agent representing the seller was involved in the sale of the capital business asset, a commission not to exceed 15 percent of the total gross sales price as shown on federal form 4797, federal form 6252, federal form 1065 schedule D, and federal form 1040 for the sale of business assets; or*
  - b. If the partner, proprietor or member acts as a co-broker, the maximum deduction shall be the difference between the amount determined in a. above and the amounts paid to other brokers or agents.*

*(e) An unincorporated business organization claiming a compensation deduction shall bear the burden of proving that all proprietors, partners or members for whom the deduction is being claimed provided actual personal services to the unincorporated business organization at*

*any time during the taxable period. Once the unincorporated business organization meets its burden, the amount of the compensation deduction shall be presumed to be reasonable, pursuant to Rev 303.01(c), unless the department proves by a preponderance of the evidence that the deduction claimed by the unincorporated business organization is clearly unreasonable. In addition, the department shall bear the burden of proof for any change to the compensation deduction of an unincorporated business organization.*

*(f) In lieu of maintaining records relating to the compensation deduction allowance pursuant to Rev 303.01(c), an unincorporated business organization or group of related business organizations, as defined in RSA 77-A:4, III(f), may elect the record-keeping safe harbor pursuant to RSA 77-A:4, III(c) and (d) by deducting up to \$50,000 as total compensation for the tax year, provided that a group of related business organizations with corporate members shall reduce its record-keeping safe harbor deduction by any compensation taken on the federal tax returns of the corporate members. If an unincorporated business organization or group of related business organizations is under audit review by the department and did not elect the record-keeping safe harbor on the return being audited, the unincorporated business organization or group of related business organizations may elect the record-keeping safe harbor during the audit review by filing an amended return reporting a compensation deduction of up to \$50,000 as total compensation for the tax year under audit review, which the department shall accept as reasonable.*

*(g) The compensation deduction shall not reduce the taxable business profits of the unincorporated business organization to below zero.*

*(h) An unincorporated business organization that deducts the record-keeping safe harbor amount of up to \$50,000 as total compensation for the tax year shall not be required to keep records as provided under Rev 303.01(i).*

~~(d)(i) In order to support the reasonableness of the compensation deduction for a proprietor, partner, or member~~*An unincorporated business organization that deducts in excess of the record-keeping safe harbor amount of \$50,000 as total compensation for the tax year shall maintain-keep such records as may be necessary to indicate the-determine that the compensation deduction is reasonable in accordance with Rev 303.01(c), including records that demonstrate:*

- ~~(1) The amount of time required to perform the actual Ppersonal services provided by the individual-proprietary, partners or members for whom for-the business organization claimed the compensation deduction;~~
- ~~(2) the personal services for the business organization taking the deduction; and~~
- ~~(3) The methods used to determine the amount of the compensation deduction~~*The nature, extent and scope of the proprietor, partner or member's work in the business organization, which may include the position, time devoted, education or skill required, and duties performed;*
- (3) Any salary policies, either in writing or otherwise, for employees concerning salary determinations, salary increases, bonus payments, when bonuses are paid, and to whom bonuses are paid, as well as the length of time such policies have been in place or when the business organization adopted such policy;*

*(4) Any methods used to determine the amount of the compensation deduction prior to claiming the compensation deduction or to justify the amount of compensation deduction subsequent to claiming the compensation deduction, including (i) any analysis of compensation paid by similar business organizations in the same industry using compensation data from industry statistics; (ii) any analysis of the general economic conditions affecting the business organization's performance; and (iii) any other comparative analyses performed to determine the amount of the compensation deduction; and*

*(5) Any documentation that (i) the compensation paid in prior years was insufficient and (ii) the amount of the current year's compensation was intended as compensation for the prior underpayment.*

~~(e) A business organization may utilize comparative compensation data from:~~

~~(1) Business organizations of similar size, volume and complexity from industry statistics; or~~

~~(2) Publications such as the most current editions of:~~

~~a. The Occupational Outlook Handbook published by the U.S. Department of Labor, Bureau of Labor Statistics, available at [www.bls.gov](http://www.bls.gov); and~~

~~b. The New Hampshire Wages and Benefits published by the New Hampshire Department of Employment Security, available at [www.nhes.state.nh.us](http://www.nhes.state.nh.us), as a reference point.~~

~~(f) Each proprietor, partner, or member described in (b) above shall be allowed a minimum deduction of \$6000.~~

~~(g) In determining the maximum deduction allowable under RSA 77 A:4, III (b) for the proprietor's, partner's, or member's compensation, the proprietor, partner, or member shall utilize the sum of the following amounts included on their federal income tax schedules:~~

~~(1) The sum of the following amounts from the federal income tax returns of the business organization:~~

~~a. Net profit or loss from federal form 1040, schedule C;~~

~~b. Net farm profit or loss from federal form 1040, schedule F;~~

~~c. Ordinary income or loss from trade or business activities from federal form 1065, schedule K-1;~~

~~d. Guaranteed payments to a partner or member from federal form 1065, schedule K-1; and~~

~~e. Income, expenses or losses from business activities in the regular trade or business or the partnership or limited liability company taxed as partnership for federal tax purposes that are specifically allocated to the individual partner or member;~~

~~(2) Net income or loss, but not less than zero, from rental properties from federal form 1040, schedule E, federal form 8825 and federal form 4835; and~~

~~(3) If the proprietor, partner or member acted as the broker or agent the following shall apply:~~

~~a. If no other broker or agent representing the seller was involved in the sale of the property, a commission not to exceed 15% of the total gross sales price as shown on federal form 4797, federal form 6252, federal form 1065 schedule D, and federal form 1040 for the sale of business assets; or~~

~~b. If the partner, proprietor or member acts as a co-broker, the maximum deduction shall be the difference between the amount determined in a. above and the amounts paid to other brokers or agents.~~

~~(h)(j)~~ A partnership business organization electing to be taxed as a corporation for federal income tax purposes shall:

(1) Not take a compensation deduction under RSA 77-A:4, III; and

(2) Take a reasonable compensation deduction as allowed under ~~the IRC~~ **Internal Revenue Code section 162** when such deduction is:

a. Taken on the entity's federal corporate return filed with the Internal Revenue Service; and

b. In accordance with Rev 302.15.

~~(i)(k)~~ Where a proprietor, partner, or member provides **actual** personal services for multiple business organizations, the records of each **business** organization shall comply with the requirements of ~~(e)~~ **Rev 303.01(i)** above.

~~(j)(l)~~ Where a proprietor, partner, or member provides **actual** personal services for multiple business organizations, the deduction claimed by each business organization shall be for the **actual** personal services rendered to it by the individual in the capacity of the proprietor, partner, or member of the specific business organization for which the deduction is taken.

~~(k)(m)~~ Remuneration for the **actual** personal services performed by a spouse shall be deductible:

(1) As compensation in determining the gross business profits of the business organization when the spouse is an employee; or

(2) Under the provisions of RSA 77-A:4, III if the spouse is not an employee of the business organization and performs the personal services as a surrogate for the proprietor, partner or member.

APPENDIX

Rev 303.01	RSA 21-J:13, I; RSA 77-A:4,III
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