In The Matter of the Petition of "M", Inc.

for a Declaratory Ruling

DOC #4276, Effective June 29, 1987

Pursuant to RSA 541-A:1, I-b; 541-A:2, I(c); and REV PART 209 of the Code of Administrative Rules, "M", Inc. , through its accountant and agent, "A" Company, CPA's of .... Street, P.O. Box ...., ..., New Hampshire, (zip code), has petitioned the Department of Revenue Administration for a declaratory ruling stating that:

1. There is a statutory or equitable exception to the language of RSA 77-A:2 which would permit a corporate taxpayer to take a federally unusable charitable contribution carryover as a pre-New Hampshire adjustment to the federally determined "taxable income before net operating loss and special deductions" so that an "adjusted gross business profits" figure could be calculated and substituted for the "Gross Business Profits" figures of RSA 77-A:1, III a.

2. There is a statutory or equitable rule which would permit a corporate taxpayer to adjust its gross business profits in determining its taxable business profits (RSA 77-A:4) whereby an unused federal 19-- charitable contribution which is carried forward federally, and which remains unusable on both the 19-- and on the final 19-- return could be utilized on the final New Hampshire return to partially offset the unique New Hampshire adjustment for Internal Revenue Code §337 gains.

The Petitioner presents the following facts:

1. "M", Inc. has been incorporated and was doing business in the State of New Hampshire from 19-- until ... , 19-.

2. During their year ended August --, 19--, "M", Inc. made the following charitable contributions:

Qualified Research Property, as defined in RSA 77-A:1 X

and IRC §170(e) (4), contributed to "'B" University (Limited to twice the corporation's cost)

$xx,xxx Cash xxx $xx,xxx

3. During the years ended August --, 19-- and 19--, "M" , Inc. sustained net operating losses for both federal and state tax purposes.

4. On June --, 19--, "M", Inc. adopted a Plan of Liquidation pursuant to IRC §337. On June --, 19--, most of its assets were sold. Between June -- and August --, its remaining assets were distributed to its shareholders.

5. Since substantially all of the gain on the June -- asset sale was not recognized for federal purposes, the corporation's final federal tax return will reflect a loss, and the contributions from 19-- will never have been deducted.

6. Since the State of New Hampshire does not recognize the provisions of IRC §337, the gain on the June -- sale is reflected in the state return, and, as such, the state return will reflect taxable business profits in excess of $x million.

7. The provisions of RSA 77-A:4, XII allowed "M", Inc. to deduct $xx,xxx from its business profits for the year ended August 19--, even though no such deduction was allowed on the federal return due to the fact that the federal return reflected a loss. This occurs because RSA §77-A:4 XII (originally enacted in 1983 as subsection VIII) allows an entity to claim the full

deduction (up to twice the entity's basis in the property) for research property (as defined in RSA §77-A:1 X) without regard to the limitation (10% of taxable income) imposed on the federal return.

FIRST RULING REQUEST. In the first ruling request taxpayer has asked for an adjustment to "taxable income before net operating loss and special deductions" on some intervening schedule between the federal form 1120 and the New Hampshire business profits tax return for unused charitable contribution carryovers. We certainly cannot by New Hampshire rule change the amount that properly appears on a federal form; and the statute unambiguously looks to that line as its tax base.

It is clear that RSA 77-A:1, III (a) intends to start the business profits tax calculation with a properly computed federal return, ipso facto, See: Shangri-La, Inc. v. State of New Hampshire, 113 NH 440; 209 A2d 385 (1973); and Estate of Kennett v. State of New Hampshire, 115 NH 50; 333 A2d 452 (1975). Recently the Department sought modification of this rule in circumstances where. it felt that taxpayers were taking advantage of New Hampshire's literal application of RSA 77-A:1, III in Bradley Real Estate Trust v. Everett V. Taylor, Commissioner, Department of Revenue Administration, 128 NH_______ (August 12, 1986). Justice Brock wrote in that decision that,

The statute is very clear. Gross business profits equal the "taxable income before net operating loss deduction and special deductions" on the United States corporate income tax form. RSA 77-A:1, III (a) (Supp. 1975). Line 28 of that form is labeled "[t]axable income before net operating loss deduction and special deductions." Thus, RSA 77-A:1, III(a) (Supp. 1975) directs the taxpayer, in preparing its New Hampshire business profits tax return, to transcribe the amount shown on line 28 of the federal form. This is precisely what Bradley did.

Thus, it is clear that neither the taxpayer nor the State can adjust the line 28 figure prior to its inclusion on the New Hampshire business profits tax return.

No argument has been advanced by the taxpayer which would lead the Department to believe that the business organization is asymmetrical with the federal form. In fact, we would find it a difficult argument to advance indeed that the charitable contributions of an enterprise are either the action of a discrete business enterprise or actions of such a nature which would not diminish or destroy the underlying business activity. Even if this burden could be met, and the charitable contributions of 19-- could be segmented from the 19-- entity's return, we see no mechanism for re-incorporating these amounts into the same entity for 19-- without violating the constitutional "amount received" principle.

Thus, the Department of Revenue Administration rules based upon the facts presented, and limited to those facts that "M", Inc. may not adjust the "taxable income before net operating loss and special deduction" figure before beginning its calculation of New Hampshire Taxable Business Profits on form NH-1120. An "adjusted gross business profits figure" is not allowable for "M", Inc.

SECOND RULING REQUEST. Clearly, the deduction is not allowable federally, and the State cannot modify the properly computed amount shown on the federal form 1120 at line 28. As the first ruling request indicated, there is no authority for an adjustment schedule which would modify line 28 between the federal and New Hampshire forms. Clearly, to do so would be to not treat taxpayers equally. No other taxpayer adjusts line 28 before utilizing the New Hampshire forms unless due process, discrete business enterprise arguments are raised.

For much the same reason the Department of Revenue Administration cannot identify a place where the taxpayer can take his unused charitable contributions as an adjustment pursuant to RSA 77-A:4. There are two clear reasons for this result. (1) No provision is made in RSA 77-A:4 to allow the same floating deduction to other taxpayers and (2) the concept of a 19-- deduction taken in 19-- flies in the face of the "amount received" concept upon which the business profits tax statute was adopted and defended before the New Hampshire Supreme

Court. Both arguments speak ultimately to the equality issue. The first is statutory equality; the second is policy equality.

In the first area we note that RSA 77-A is designed like a mathematical equasion. Every effort is made to be clear. RSA 77-A:2 states:

77-A:2 Imposition of Tax. A tax is imposed at the rate of . . . percent upon the taxable business profits of every business organization.

The term "taxable business profits" is specifically defined in RSA 77-A:1, IV as:

IV. "Taxable business profits" means gross business profits adjusted by the additions and deductions provided in RSA 77-A:4 and then adjusted by the method of apportionment provided in RSA 77-A:3.

Each of the parts of the RSA 77-A:1, IV equation, "gross business profits" and the "additions and deductions provided in RSA 77-A:4" are specifically defined. "Gross Business Profits" is defined in RSA 77-A:1, III (a), (f) which reads:

III. "Gross business profits" means:

(a) In the case of a corporation, except "S" corporations, or any other business organization required to make and file a United States corporation income tax return, or in the case of a corporation which does not make and file a separate United States corporation income tax return for itself because it is a member of an affiliated group pursuant to the provisions of chapter 6 of the United States Internal Revenue Code (1954) as amended, the amount shown or which would be shown as taxable income before net operating loss deduction and special deductions on such return.

(b) In the case of "S" corporations or any other business organizations required to make and file an "S" corporation return, the net profit from all business activity determined in accordance with rules adopted by the department of revenue administration under RSA 541-A.

(c) In the case of a partnership or any other business organization required to make and file a United States partnership return of income, the amount shown as ordinary income increased by the amount shown as payments to partners, items of income or deductions specifically allocated to partners, and the net amount of any gains from the sale of partnership assets.

(d) In the case of a proprietorship, the amount shown as net profit, net income from rents, and net farm profits on schedules C, E, and F of the proprietor's United States income tax return plus the net amount of any gains from the sale of assets held for use in business activity as shown on said return.

(e) In the case of a trust, estate, or any other business organization engaging in business activity, the amount of net profit from such business activity and the net amount of any gains from the sale of assets held for use in business activity.

(f) In the case of any business organization which is part of a water's edge combined group and which does not make or file a United States income tax return or schedule under subparagraphs (a)-(d), the amount of net income as would be determinable under the provisions of the United States Internal Revenue Code (1954) as amended and applied within the concepts of RSA 77-A for such business organizations.

For this part of this taxpayer's tax calculation equation the taxpayer has gone to RSA 77-A:, III (a) and transcribed the number found on its corresponding federal form. As the first ruling request indicates, this number is not subject to adjustment.

The second part of this tax calculation equation is found in RSA 77-A:4. It reads in full:

77-A:4 Additions and Deductions (Chapter 318, Laws of 1983). The following adjustments shall be made to gross business profits in determining taxable business profits:

I. In the case of a business organization which is subject to taxation under RSA 77, a deduction of such amount of gross business profits as is attributable to income which is taxable or is specifically exempted from taxation under RSA 77.

II. A deduction of such amount of gross business profits as is attributable to income derived from interest on notes, bonds or other securities of the United States.

III. In the case of a proprietorship or partnership, a deduction equal to a fair and reasonable compensation for the personal services of the proprietor or partners actually devoting time and effort in the operation of the enterprise. The purpose of this paragraph is to permit deduction from gross business profits of a proprietorship or partnership only of such amounts as are fairly attributable to the personal services of the proprietor or partners. If there is occasion to determine the reasonableness of a deduction claimed under this paragraph, the commissioner shall consider the claimed deduction in light of compensation for personal services of employees in positions requiring similar responsibility, devotion of time, education and experience in business organizations of similar size, volume and complexity. In addition, the commissioner shall take into account the value of the proprietorship or partnership of the labor of its employees, the proprietor, or any of the partners, and the use of their property and any other factor which may reasonably assist the commissioner in making a determination. Such determination by the commissioner shall be deemed reasonable unless the taxpayer proves to the commissioner, by a preponderance of the evidence upon the standards set forth in this paragraph and after notice and hearing, that the deduction claimed by the taxpayer is not grossly excessive. Provided, that a taxpayer ascertaining its gross business profits in this state by the allocation procedure established in RSA 77-A:3 is allowed only such percentage of the deductions allowable in paragraphs II, III, and IV as has been applied by it in ascertaining it's gross business profits in this state. Provided further that subject to the preceding sentence, a minimum deduction of $3,000 shall be allowed on account of the proprietor or each partner actually devoting time and effort in the operation of the enterprise.

IV. In the case of a corporation which is the parent of an affiliated group pursuant to the provisions of chapter 6 of the United States Internal Revenue Code (1954) as amended, a deduction of such amounts of gross business profits as are derived from dividends paid to the parent by a subsidiary or subsidiaries whose gross business profits have already been subject to taxation under this chapter during the same taxable period. The purpose of this deduction is to prevent double taxation on the identical gross business profits of a controlled corporation or group of corporations and its parents.

V. In the case of a business organization which is a participant in a joint venture which itself is taxable under this chapter or a partnership which is a partner in a second partnership which itself is taxable under this chapter, a deduction of such amounts of gross business profits as are derived from distributions from the joint venture to the business organizations or from the partnership to the second partnership which have already been subject to taxation under this chapter during the same or any overlapping fiscal period. The purpose of this deduction is to prevent double taxation on the identical gross business profits of a joint venture and its participating business organizations or a partnerships which is a partner in a second partnership.

VI. In the case of a corporation which is the parent of a domestic international sales corporation (DISC) as defined in section 992 of the United States Internal Revenue Code (1954), as amended, a deduction of the distribution to the parent company by the DISC required by the provisions of subsection 995 (b) (1) (D) of the internal Revenue Code of 1954,

as amended, if the profits from which said distribution is made have already been subject to taxation under this chapter during the same taxable period. The purpose of this deduction is to prevent double taxation on the identical gross business profits of a DISC and its parent company.

VII. In the case of a business organization which takes any deduction for a net income tax, a franchise tax measured by net income, or a capital stock tax assessed by any state or political subdivision, an addition to gross business profits for the amount of all such deductions.

VIII. In the case of a corporation, having adopted a plan of liquidation subsequent to June 30, 1981, which has a non-recognized gain as a result of the application of the United States Internal Revenue Code (1954) section 337, as amended, an addition to gross business profits for the amount of such gain.

IX. In the case of a business organization required to adjust a portion of its wages under the United States Internal Revenue Code (1954) section 280C, as amended, a deduction from gross business profits in the amount of such adjustment.

X. In the case of a business organization which receives certain intangible income from non-unitary sources, a deduction from gross business profits for the amount of such income net of related expenses.

XI. A deduction of such amount of gross business profits as is attributable to foreign dividend gross-up as determined in accordance with section 78 of the United States Internal Revenue Code (1954) as amended.

XII. (Chapter 444:2, Laws of 1983) In the case of a business organization which makes qualified charitable contributions as defined in RSA 77-A:1, IX, or qualified research contributions as defined in RSA 77-A:1, X, the gross business profits of the organization shall be adjusted by:

(a) Adding to gross business profits the amount deducted under section 170 of the United States Internal Revenue Code (1954) as amended in arriving at federal taxable income; and

(b) Deducting from gross business profits an amount equal to the sum of the taxpayer's basis in the contributed property plus 50 percent of the unrealized appreciation, or twice the basis of the property, whichever is less.

No aspect of RSA 77-A:4 permits a deduction in one tax period for expenses of a prior period. We understand that such a "floating deductibility" characteristic is inherent in certain aspects of the federal revenue code, i.e., carry-forward and carry-back provisions. We understand that this federal attribute necessarily carries over, flows-through to the New Hampshire return due to our acceptance of the numbers on the federal return as our starting point for calculating taxable business profits (RSA 77-A:2; 77-A:1, IV; 77-A:1, III (a)). Such an adoption of federal net income amounts is appropriate, Shangri La, Inc. v. State of New Hampshire, 113 NH 440, 442, 444; 309 A2d 285 (1973); Opinion of the Justices 95 NH 540, 542; 64 A.2d 322, 323 (1949);Opinion of the Justices, 110 NH 117, 122, 262 A.2d 290, 295 (1970); Opinion on the Justices, III NH 136, 140; 276 A.2d 821, 822 (1971) .

However, the business profits tax is otherwise premised on the basis of strict adherence to equality between taxpayers as seen through the "amount received" principle. The amounts taxed are only those amounts received during the tax year. See: Shangri-La; Estate of Kennett. Likewise, the amounts deductible in a tax on net rather than gross income are the amounts expended during the year according to the accounting practice of the taxpayer. Under such an equalized tax structure it makes no sense to permit some taxpayers to elect between years for purposes of netting prior amount spent against current income. Clearly the statute itself does not permit this. RSA 77-A:4, XII makes no reference to a "carry-over" quality in this specific deduction. Nor does any other part of RSA 77-A:4. Without express

authority, the Department is loath to authorize such a floating attribute to an allowed deduction. See: New Hampshire Constitution Part 1, Article 12; Part II, articles 5 and 6. State of New Hampshire v. United States and Canada Express Company, 60 NH 219, 236 (1880),Curry v. Spencer, 61 NH 624; (1982); William v. State, 81 NH 341; 125 A 661 (1924),Opinion of the Justices, 77 NH 611; 93 A 311 (1915), Opinion of the Justices, 81 NH 552; 120 A 629 (1923), Arthur J. Conner v. State, 82 NH 126; 130 A 357 (1925), Bemis Brothers Bag Co. v. Claremont, 98 NH 446, 450; 102 A2d 512 (1954); Opinion of the Justices, 82 NH 561, 569; 138 A 284 (1927), Opinion of the Justices, 106 NH 202, 204; 205; 208 A.2d 458 (1965); Opinion of the Justices, 110 NH 117, 118; 262 A.2d 290 (1970).

This is, therefore, the second area of equality; policy equality. The 1903 amendment to the New Hampshire Constitution Part II Article 6 and all of the subsequent case law points to the fact that the business profits tax is a property tax based on the "amount received" during a year. The "amount received" by the instant taxpayer includes a

§ 337 add-back pursuant to RSA 77-A:4, VIII. This gain, not recognized by the internal Revenue Service, was an "amount received" during the year and is an appropriate subject for tax because all taxpayers who have such a gain must include it in New Hampshire taxable income. However, the taxpayer requests that we authorize them alone to deduct an amount paid in a prior year to reduce its "amount received" this year. Not only would this be a special classification of taxpayers prohibited by Opinion of the Justices, 84 NH 559; 149 A 321 (1930) ; Opinion of the Justices, 106 NH 202; 208 A2d 458 (1965) , it would contravene the "amount received" doctrine of Arthur J. Conner v. State, 82 NH 126; 130 A 357 (1925) Opinion of the Justices, 77 NH 611; 93 A 311 (1915) and Opinion of the Justices 81 NH552, 120 A 629 (1923).

Thus, the Department of Revenue Administrative rules based upon the facts presented, and limited to those facts that "M", Inc. may not adjust its Gross Business Profits in determining its taxable business profits by an unused 19-- charitable contribution under the provisions of RSA 77-A:4. Additionally, no equitable argument runs in favor of granting the taxpayer's request because it would cause an inequality, not assure an equality between taxpayers.

Everett V. Taylor, Commissioner