KMWL Associates, Ltd.

v.

Department of Revenue Administration

Docket No. 11486-91BP

DECISION

Introduction

The "Taxpayer" appeals, pursuant to RSA 21-J:28-b, IV and RSA 77-A:13, the Department of Revenue Administration's (DRA) assessments of additional business profits tax, penalties and interest issued on October 12, 1989 for the tax year December 31, 1987. The Taxpayer failed to appear, but consistent with out Rule, TAX 102.03(g), the Taxpayer was not defaulted. This decision is based on the evidence presented to the board. For the reasons stated below, the appeal is denied.

Facts

The Taxpayer, KMWL, is a New Hampshire limited partnership which owned and operated a shopping center, known as the K-Mart Plaza Shopping Center (Center) in Lebanon, New Hampshire. The Center was purchased on August 1, 1980 and sold on October 15, 1987. The general partner of KMWL is Recs No. 1, Inc., a Texas Corporation. None of the limited partners are New Hampshire residents.

For federal income tax purposes, the Taxpayer filed partnership income tax returns distributing income and expenses reportable by each of the partners for both federal and state (except New Hampshire) income tax purposes. No business profits tax returns were filed from 1980 through 1986. In the course of a regular review of sales of real property during 1987, DRA's collection division noticed the sale of the Center and advised the Taxpayer that it was required to file a 1987 business profits tax return. The Taxpayer filed a New Hampshire Partnership business profits tax return on August 31, 1989 based upon income received from the rental and sale of the Center. The return for the year at issue, December 31, 1987, was due April 16, 1988 and the dispute arose from the deduction taken by the Taxpayer for compensation. The Taxpayer remitted $10,466 for the tax due plus interest in the amount of $2,159 for a total of $12,625. The Taxpayer reported the following:

Total gross business profits from sale of the Center -	$2,783,730
Total compensation deduction	
Commission on the sale	(1,960,000)
Personal services rendered	(695,000)
Total taxable income	$128,730

Further, the Taxpayer filed federal tax returns reporting:

Gross rental income	$620,970
Total expenses	(725,329)
Net loss	($104,359)

A total gain of $2,871,968 on the sale of the Center was reported as follows:

Gross sales price	$4,900,000
Adjusted basis	2,028,032
[Cost plus expense of sale - $3,145,504]	
[Depreciation allowed - ($1,117,472)]	
Total gain	$2,871,968

DRA adjusted the amount of taxable business profits shown on the return by reducing the amount of compensation taken as a deduction by the Taxpayer under RSA 77-A:4, III (1991) to $552,097. The basis for the adjustment was the allowance of an approximate 10% commission on the gross selling price of the business assets plus 10% of gross rents as a management fee for operating the rental aspect of the business. The Taxpayer was then assessed additional business profits tax of $168,809 plus interest pursuant to RSA 77-A:7-a (1991) and RSA 21-J:28 (1988). In addition, DRA imposed late payment and late filing fees pursuant to RSA 21-J:31 and 33 (1988) in the amounts of $2,616.50 and $1,046.60. The total assessment of $213,623.10 was issued by DRA in a tax notice dated October 12, 1989.

On November 10, 1989 the Taxpayer requested that DRA schedule an administrative hearing in accordance with RSA 77-A:13 (1991) and N.H. Code Admin. R. Rev 207.03 (1989). A hearing was held and on April 13, 1992, the department's hearing officer issued a final order denying and sustaining the DRA assessment and a revised assessment was ordered to reflect the decision as follows:

Tax Due		$170,966.00
Interest		105,656.00
Late Filing Charge		17,097.00
Late Payment Charge		42,742.00
Total Assessed		$336,461.00
Less Interest Paid	(2,159.00)	
		$334,302.00

On May 8, 1992, the Taxpayer filed an appeal of the DRA decision with the board of tax and land appeals (board).

Issues

There are three issues of law before the board:

1) Did the DRA incorrectly compute the gain from the sale of the Center?

2) Should a portion of the Taxpayer's gross business profits be allocated outside of N.H.?

3) If any tax is held to be due with respect to the Center, should penalties be waived?

Arguments

The Taxpayer argued the following:

1) The DRA assessment produced an unfair result.

2) A three part allocation formula based upon payroll, property and sales should be applied to reduce the gain in order to attain a more fair and appropriate result to the Partnership and to its partners.

3) Penalties should be waived because the failure to file was based upon reasonable cause and not due to negligence or disregard of rules and regulations.

4) The 1987 tax return should be accepted or the amount subject to business profits tax should not exceed $132,345.

DRA argued the following:

1) The assessment is supported by the basic principles of the business profits tax law and does not produce an unfair result.

2) Apportionment in this case is not appropriate because in order for a taxpayer to be eligible to apportion its income, it must be subject to the

jurisdiction of another state to impose a tax similar to that of the business profits tax.

3) Penalties should not be abated because the Taxpayer has not offered any factors or legal argument to support its argument that the failure to file and timely pay was based upon reasonable cause and was not due to negligence or disregard of rules or regulations.

4) The Taxpayer has the burden to show that it merits an abatement of the penalties assessed and the Taxpayer has not sustained its burden.

Board's Rulings

1) Did the DRA incorrectly compute the gain from the sale of the Center?

The Taxpayer stated that the partnership purchased the Center in 1980 for a total sum of cash in the amount of $1,656,750. The Center operated unprofitably for several years and was sold by the partnership in 1987 at which time the partnership received and distributed to its partners a net sum of cash in the amount of $2,376,578. Therefore, the total "real" economic profit realized by the partnership was only $719,828. The Taxpayer argued that although the larger amount of gain was reported for Federal purposes, that the partners in the Partnership had previously been allowed the benefit of substantial deductions, which offset the Federal tax owing upon the apparent gain from the sale of the Center. The Taxpayer further argued that had New Hampshire allowed similar offsets, that little or no tax would be payable by the partnership as a result of the sale of the Center. Therefore, DRA should not be allowed to apply the New Hampshire tax based on "hypothetical" income and $719,828 is the correct amount of gain which should be used as a basis for computing the New Hampshire tax. From that amount, the compensation deduction of $490,000 plus $62,097 previously allowed by DRA should be deducted resulting in New Hampshire taxable income of $229,828 subject to tax.

DRA stated they do not dispute the amount of total gross business profits reported or the methodology used by the Taxpayer on their 1987 New Hampshire partnership business profits tax return which return has not been amended. DRA contends that the income reported on the federal schedules and on the New Hampshire business profits tax return derived from rental income and the sale of the Center has been correctly reported for New Hampshire purposes in accordance with DRA rule Rev. 302.03 (b) and RSA 77-A:1, III (c) (Supp. 1986), and argued the Taxpayer's requests for adjustments on their New Hampshire return are not supported by New Hampshire law and the total gross business profits as calculated and reported by the Taxpayer on its 1987 return is correct.

The starting point in the interpretation of a statute is the language of the statute itself. State Employees' Ass'n of N.H. v. Bd. of Trustees, 120 N.H. 272 (1980). When the language used in a statute is plain and unambiguous, its meaning may not be modified by construction. Corson v. Brown Prods., Inc., 119 N.H. 20 (1979). 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. Bradley Real Estate Trust v. Taylor, Commissioner, 128 N.H. 441 (1986).

The board finds that there is no basis in the law that the starting point for determining gross business profits be anything other than taxable income as reported to the federal government. New Hampshire defines gross business profits as what is filed with the Internal Revenue Service. DRA rule Rev. 302.03 (b) states:

> The basis of the property sold or exchanged shall be determined using the requirements of the Internal Revenue Code, as defined in RSA 77-A:1 XX. An example of the basis is the cost of the asset less the depreciation allowed or allowable.

New Hampshire treats partnerships as taxable entities in and of themselves. Thus, it is not the partners that are taxable, but the partnership. RSA 77-A:1, I states:

> ...A partnership, estate, trust, "S" corporation, real estate investment trust, regulated investment company, or any other such entity whose net income is reportable by the true owners either directly or indirectly shall be subject to tax at the entity level, and no part of such earnings or loss shall be included in the calculation of the gross business profits of the owners of such entity.

Further, New Hampshire's statute has no provision allowing prior year losses to be deducted from the gross business profits. RSA 77-A:1, III. (c) states:

> 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.

The Taxpayer did deduct $104,359 attributed to the 1987 rental real estate activity of the Center.

Although the IRS allows the partnership value to flow through to the partners, New Hampshire law is clear. The Taxpayer is the partnership, not the partners. The Taxpayer reported income on the federal returns and on the New Hampshire business profits tax return which was derived from rental income and the sale of the Center. The board finds the total gain of $2,871,968 as reported is correct in accordance with New Hampshire statute.

2) Should a portion of the Taxpayer's gross business profits be allocated outside of N.H.?

The Taxpayer argued that, alternatively, the three part formula, based upon property, sales and payroll, should be applied because (a) the partners all live outside New Hampshire and have been obligated to pay state taxes on the profit from the sale of the Center, (b) the management company, which conducted all of the management activities with respect to the Center, maintained two offices outside New Hampshire from which the management activities were conducted, and (c) all business and economic aspects of the sale of the Center were carried on outside New Hampshire for bona fide business reasons.

RSA 77-A:3 I (supp.) states:

> A business organization which derives gross business profits from business activity both within and without this state, and which is subject to a net income tax, a franchise tax measured by net income, or a capital stock tax in another state or is subject to the jurisdiction of another state to impose a net income tax or capital stock tax upon it, whether or not such tax is actually imposed, shall apportion its gross business profits so as to allocate to this state a fair and equitable proportion of such business profits.

The board finds no apportionment of income is warranted because the Taxpayer has presented no evidence to show that it was taxable in any other state that, which without such apportionment, would have subjected it to double taxation.

In order to be eligible to apportion its income, the Taxpayer must prove to the board that it is subject to another state's jurisdiction to impose a business profits tax. Richardson Inv. Management, Inc. v. N.H. Bd. of Taxation,

119 N.H. 159 (1979); Scott & Williams, Inc. v. Board of Taxation, 119 N.H. 184 (1979); Pandora Indus., Inc. v. State Dep't of Revenue Ad., 118 N.H. 891 (1978); Scott & Williams, Inc. v. Board of Taxation, 117 N.H. 189 (1977). The Taxpayer has not satisfied that burden. The Taxpayer has presented no evidence to show that it conducted business activity or owned business property outside of New Hampshire. On its business profits tax return, 100% of the business activity was reported by the Taxpayer as having occurred in New Hampshire. Further, the partnership (a) had no employees, its contractual agreement with a management firm does not qualify that firm as an "employee"; (b) owned only the property in New Hampshire, and (c) was not taxed on the sale of the Center in another state. **3) If any tax is held to be due with respect to the Center, should penalties be waived?**

With respect to the late filing penalty, RSA 21-J:31 (1988) states:

> Any taxpayer who fails to file a return when due, unless an extension has been granted by the department, shall pay a penalty equal to 5 percent of the amount of the tax due or $10, whichever is greater, for each month or part of a month during which the return remains unfiled. The total amount of any penalty shall not, however, exceed 25 percent of the total tax due or $50, whichever is greater. This penalty shall not be applied in any case in which the failure to file was due to reasonable cause and not willful neglect of the taxpayer. The amount of the penalty is determined by applying the percentages specified to the net amount of any tax due on the return after crediting any payments made through estimating or other means.

With respect to the late payment penalty, RSA 21:J-33 (1988) states:

> In addition to amounts due under this subdivision, penalties shall be imposed for failure to pay taxes when, and as, due as follows:
>
> I. If the failure to pay is due to willful neglect or intentional disregard of laws or rules, but without intent to defraud, the penalty shall be equal to 10 percent of the amount of the nonpayment or underpayment.
>
> II. If the failure to pay is due to fraud, the penalty shall be 50 percent of the amount of the nonpayment or underpayment. If a penalty is imposed under this paragraph, no addition to tax shall be imposed under this subdivision for the same nonpayment or underpayment.

The Taxpayer argues that penalties should be waived because the failure to file the New Hampshire tax return by the Partnership was a unique and unusual case based upon reasonable cause and was not due to negligence or disregard of rules and regulations because the Taxpayer was unaware that there existed any possibility of New Hampshire tax liability.

While the New Hampshire tax structure may differ from other states, it is incumbent upon the Taxpayer to make itself fully aware of the tax laws in New Hampshire if it intends to do business in this State. It is no excuse for a multi-million dollar national partnership to claim ignorance of the tax structure. New Hampshire statutes are clearly and unambiguously written. Surely a California attorney should be able to decipher them.

The Taxpayer has the burden of proving that the assessment was disproportionately high or unlawful, resulting in the Taxpayer paying an unfair and disproportionate share of taxes. Appeal of Town of Sunapee, 126 N.H. 214 (1985). The Taxpayer failed to offer any argument or evidence to support its burden of proving the DRA assessment of penalties was in error or that the failure to file was due to reasonable cause and not willful neglect. In fact, the Taxpayer clearly has not owned up to its tax filing responsibilities in that it had neglected to file business profits tax returns from 1980 through 1986. The board finds that a business operating in the state for a period of 7 years

who has not inquired as to its tax obligations is clearly neglecting its responsibilities and finds the penalties assessed were proper.

Conclusion

Appeal denied.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

George Twigg, III, Chairman

Paul B. Franklin, Member

Michele E. LeBrun, Member

CERTIFICATION

I hereby certify that the foregoing decision has been mailed, postage prepaid to Daniel L. Raiskin, Esq., Attorney for the Taxpayer; and V. Hummel Berghaus, IV, representative for the Department of Revenue.

Dated: December 28, 1993

Valerie B. Lanigan, Clerk

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