

Ralph Sweatt

v.

Department of Revenue Administration

Docket No.: 17728-99BP

DECISION

The "Taxpayer" appeals, pursuant to RSA 21-J:28-b, the "DRA's" determinations of the Taxpayer's 1992, 1993, and 1994 business profits tax, interest, late filing penalties, and substantial understatement of tax penalties totaling \$33,284 for tax year 1992, \$23,304 for tax year 1993 and \$16,658 for 1994. For the reasons stated below, the appeal for abatement is granted.

The Taxpayer has the burden of showing that DRA erred in its determination of the tax. TAX 209.04; Appeal of Steele Hill Development Company, Inc., 121 N.H. 881 (1981). The Taxpayer carried this burden.

The Taxpayer argued the assessments were excessive because:

- (1) personal compensation for earlier years should be allowed where there is evidence of superior performance during the three tax years by applying provisions of IRC § 162, the federal code relative to salary deductions specifically allowable to corporations;
- (2) the state's compensation calculations understate the value of Mr. Sweatt's contribution as a truck driver, truck mechanic and transport manager based on his years of experience; a review of industry statistics relative to trucking businesses indicate Mr. Sweatt was a superior performer

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during the three tax years and should be entitled to a higher than normal compensation deduction;

(3) DRA's personal compensation calculations do not include any value attributable to Mr. Sweatt being chief executive officer (CEO) of this business; and

(4) the state's personal compensation calculations do not include any amount for benefits, such as health care, vacations, retirement, social security and medicaid taxes, etc..

The DRA argued the assessment was proper because:

(1) DRA was lenient in its calculation of personal compensation by granting 80 hours per week as an estimate for Mr. Sweatt's time and 40 hours per week for Mrs. Sweatt's time despite the lack of any time logs;

(2) the hourly rates for the different general duties performed by Mr. Sweatt are based on the average level of wages from the 1992 New Hampshire Survey of Wages and were adjusted for the higher valued functions above 40 hours at time and a half; and

(3) while no specific adjustments for benefits were included, the use of high undocumented hours with the time and a half overtime adjustment compensate for the lack of specific itemization of benefits.

Board's Rulings

Based on the evidence, the board finds the amount of the RSA 77-A:4 III compensation for personal services deduction should be increased by 25% for each of the three years above the amount determined by DRA.

The board will address separately the arguments presented by the parties. However, first

the board must comment on the lack of reasonableness of the Taxpayer's actions, and in particular, those of the Taxpayer's return preparer, Mr. Francis J. Dineen. All three years tax returns filed by Mr. Dineen indicated the amount of compensation for personal services to be identical with the gross business profits calculated each year ranging from \$258,432 to \$318,735. Mr. Dineen supplied no supporting documentation or explanation at the time the returns were filed to support "zeroing out" the gross business profits. Only when DRA initiated an audit of the returns did Mr. Dineen start to argue how the personal compensation deduction should be calculated. In correspondence too voluminous to fully enumerate in this decision, Mr. Dineen argued a higher deduction for personal compensation in each successive correspondence with DRA. In his final correspondence with DRA, Mr. Dineen argued Mr. Sweatt's personal compensation should also include \$169,000 in excess of his hourly personal compensation for truck driver, mechanic and manager to account for him being the CEO of the proprietorship. These snowballing arguments occurred without any documentation of the hours actually worked by Mr. Sweatt in his various capacities as required by REV 303.02(e). Based on the board's review of the record, Mr. Dineen continued to overreach the bounds of reasonableness by developing arguments as the case proceeded through DRA to justify the unsubstantiated deduction for personal services on the returns. Contrary to Mr. Dineen's assertion at the close of the hearing, the board finds it was not harassment on the part of DRA that extended a resolution in this matter but rather the progressive and unreasonable arguments presented by Mr. Dineen. Application of IRC Sec. 162 to Determine Reasonable Compensation for Personal Services (Taxpayer's Arguments 1 and 2).

The board rules it need not determine whether Mr. Sweatt's performance in the three tax years in question would qualify as superior performance under the federal code. IRS § 162,

because the New Hampshire statute for determining reasonable compensation for personal services is straight forward and unambiguous. RSA 77-A:4 III (1992 through 1994 Supp.).

RSA 77-A:4 III (1992 Supp.) reads:

RSA 77-A:4 Additions and Deductions.

III. (a)

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 business organization. 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 who are natural persons, but not to permit deduction of any amounts as are fairly attributable to a return on business assets or the labor of non-owner employees of the business organization. The burden shall be upon the business organization filing the return to demonstrate the reasonableness of a deduction claimed under this paragraph, by a preponderance of the evidence. In considering 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 to the business organization of the labor of its non-owner employees, and the use of the business assets of the business organization and any other factor which may reasonably assist the commissioner in making a determination as to the reasonableness of the claimed deduction. (1992 Supp.)

When statutory language is clear and unambiguous, as it is in this case, the board must simply apply the plain meaning of the statute and need not perform any research of its legislative history. Pendrich v. Sullivan, 136 N.H. 621, 623 (1993); State v. Dyushambe, 136 N.H. 309, 313 (1992); State v. Gagnon, 135 N.H. 217, 221 (1991). The board finds RSA 77-A:4 III is relatively detailed and explicit as to how reasonable compensation for personal services is to be calculated. If it had wanted to, the legislature could have made reference to federal codes or some other manner to address the issue of superior performance but it chose not to. Thus, the

board can only apply the statute as it is clearly written.

Calculations of Reasonable Compensation of Personal Services

The board finds the DRA's total deductions for compensation of personal services are reasonable with the exception of an amount for benefits commensurate with personal services.

DRA based its calculations upon the Taxpayer's assertion of Mr. Sweatt working an average of 80 hours per week and Mrs. Sweatt working 40 hours a week. DRA then applied the three average hourly wage rates (truck driver, truck mechanic and transport manager) to Mr. Sweatt's 80 hours and a bookkeeper rate to Mrs. Sweatt's 40 hours. DRA applied a time and a half rate to 40 of Mr. Sweatt's 80 hours at the higher rates of the mechanic and manager functions. Total personal compensation for the three years for Mr. and Mrs. Sweatt range from \$109,564 to \$116,009. While Mr. Sweatt's experience as truck driver and mechanic could justify a higher hourly rate for those functions, DRA's overtime rate and adoption of 80 hours more than compensates for any underestimation of the hourly rate. The resulting average hourly rate of over \$21 is reasonable based on Mr. Sweatt's various functions as proprietor of the family trucking business. To deduct an additional amount as a CEO, goes beyond the realm of reasonableness and overstates the value of Mr. Sweatt's personal services based on "similar responsibility, devotion of time, education and experience in business organizations of similar size, volume and complexity." RSA 77-A:4 III. While certainly at times Mr. Sweatt's decisions in his operations of the business contributed greater value than a truck driver or mechanic, the board finds that the managerial rate of nearly \$35.00 an hour is a reasonable estimate of his managerial contribution for this type and size of business.

The board also finds DRA's hourly rate of \$10 for Mrs. Sweatt is appropriate for the level of her bookkeeping and other responsibilities. The board finds the Taxpayer's assertion that the

\$20 hourly rate as an “accountant and auditor” from the 1992 New Hampshire Survey of Wages is unreasonable based on the type of bookkeeping and office functions performed by Mrs. Sweatt. No evidence of wages paid to similar employees in businesses of similar size and nature were submitted by the Taxpayer to justify a \$20 hourly rate.

In short, the board finds that DRA's estimated wages for Mr. and Mrs. Sweatts' respective functions to be reasonable in toto.

However, the board finds “wages” do not completely account for all the value relative to a deduction for personal services. The board notes RSA 77-A:4 III refers to the deduction as compensation for personal services, not simply wages. Consequently, in addition to wages, a certain amount for benefits that are usually and customarily associated with such positions need to be accounted for to reflect "a deduction equal to a fair and reasonable compensation for personal services of the proprietor." RSA 77-A:4 III(a). In other words, wages are only part of reasonable compensation and an estimate for certain benefits to make up the balance of the total compensation is necessary. In this case, the board finds an estimate of benefits should consider a certain percentage for social security and medicaid taxes¹, health insurance, vacation and retirement benefits commensurate with the Taxpayer’s type of work.

DRA argued that their wage rates were generous enough to include such benefits. Despite the lack of hourly logs, we disagree. The testimony of Mr. Sweatt supports the estimate of 80 hours per week. Also the overall rate of over \$21 does not overstate the value of Mr.

¹The board has reviewed the various income tax schedules referenced in REV 303.02 (d). Self-employment taxes (social security and medicaid) are not specifically referenced. However, the board has concluded that DRA’s rules do not restrict the intent of RSA 77-A:4 III of allowing any reasonable factor in estimating compensation for personal services be considered. Inasmuch as social security and medicaid taxes are, in essence, mandatory retirement and health benefits, the board concludes they are appropriate factors to be included in calculating a deduction for personal services.

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Sweatt's personal services to such an extent to allow for benefits. Consequently, a separate accounting of benefits is necessary.

In support of benefits the Taxpayer made reference to: 1) the 1992 United States Chamber of Commerce Employees Benefits Survey which indicated 39.2% overall benefits; and 2) the board's finding of 25% benefits in Rood v. DRA, BTLA Docket No.: 17347-97BP. The board is unable to give much weight to the United States Chamber of Commerce Employees Benefits Survey because 1) the document was not submitted; and 2) no discussion was provided as to how applicable it was to either the northern New Hampshire market or the type of business the Taxpayers are involved in.

While the 25% for benefits is the same as the board found in Rood v. DRA, the board's conclusion is based solely on the facts presented in this case. Further, the board finds it is not appropriate to base its estimate on the amount of benefits the Sweatts actually availed themselves of, which appear to be minimal health and vacation benefits. On balance, considering the total wage deduction the board has found, we conclude an additional 25% for benefits is reasonable.

Penalties

DRA assessed both an RSA 21-J:31 penalty for failure to timely file and an RSA 21-J:33- a penalty for substantial understatement.

RSA 21-J:31 Penalty for Failure to File.

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 amount of the tax due or \$50, whichever is greater. This penalty shall not be applied in any case in which a return is filed within the extended filing period as provided in RSA 77:18-b, RSA 77-A:9, RSA 83-C:6, RSA 84-A:7, or RSA 84-B:7, or 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 after crediting any timely payments made through estimating or other means. (1992 Supp.)

RSA 21-J:33-a Substantial Understatement Penalty.

I. If there is a substantial understatement of tax imposed under RSA 77, RSA 77-A, RSA 78-A, RSA 78-C, RSA 82-A, RSA 83-C, RSA 84-A, or RSA 84-B, for any taxable period, there shall be added to the tax an amount equal to 25 percent of the amount of any underpayment attributable to such understatement.

II. For purposes of this section, there is a substantial understatement of tax for any taxable period if the amount of the understatement for the taxable period exceeds the greater of:

- (a) 10 percent of the tax required to be shown on the return for the taxable period; or
- (b) \$5,000.

III. For the purposes of paragraph II, the term “understatement” means the excess of:

- (a) The amount of the tax required to be shown on the return for the taxable period, over
- (b) The amount of the tax imposed which is shown on the return.

IV. The amount of the understatement as defined in paragraph III shall be reduced by that portion of the understatement which is attributable to:

- (a) The tax treatment of any item by the taxpayer if there is or was substantial authorization for such treatment; or
- (b) Any item with respect to which the relevant facts affecting the item’s tax treatment are adequately disclosed in the return or in a statement attached to

the return. (1992 Supp.)

The board finds the late filing penalties pursuant to RSA 21-J:31 for tax years 1993 and 1994 were properly assessed by DRA. Both years' returns were filed in the following October which would have been timely if the Taxpayer had paid the total tax due as determined by April 15th of each year, thus qualifying for the REV. 307.08 automatic extension of time to file the returns. Based on the Taxpayer's lack of even minimal diligence in maintaining adequate records to establish hours worked and the general unreasonableness of the Taxpayer's arguments as to the amount of deductions for personal services, the board concludes the Taxpayer did not fulfill his burden to show that his lack of timely filing was not due to wilful neglect or intentional disregard of the law or rules. Appeal of Steele Hill Development Co., Inc., 21 N.H. 881 (1981). In fact, even at the time of the hearing, the Taxpayer had not paid his taxes despite being availed in 1998 of the opportunity under the DRA's amnesty program to have all penalties and interest in excess of 10 percent excused.

Likewise, the board finds the RSA 21-J:33-a penalties for substantial understatement for tax years 1992, 1993 and 1994 are appropriate. RSA 21-J:33-a IV provides the amount of the penalty can be reduced for extenuating circumstances if there was "substantial authorization for such treatment" or if "... the relevant facts affecting the item's tax treatment are adequately disclosed in the return...." As the board has already found, the Taxpayer did not submit any supporting documentation in accordance with RSA 21-J:33-a IV (b) with its returns explaining the significant zeroing out of the gross business profits. Moreover, as already found by the board, substantial authorization did not exist for Mr. Dineen's argument of relying upon federal code IRC § 162 given the straightforward wording of RSA 77-A:4 III.

Consequently, the board finds both penalties should remain and a summary of the Taxpayer's business profits tax liabilities for all three years follows:

	1992	1993	1994
Gross Business Profits	\$318,735	\$281,055	\$258,432
Deduction for Personal Services Including Benefits	(\$136,955)	(\$141,475)	(\$145,011)
Revised Gross Business Profits	\$181,780	\$139,580	\$113,421
Tax Rate	0.08	0.075	0.07
BPT	\$14,542	\$10,469	\$7,939
Less BET Credit	\$0	\$1,015	\$1,023
BPT Net of BET	\$14,542	\$9,454	\$6,916
Overpayment from BET	\$0	\$420	\$356
Balance Due	\$14,542	\$9,034	\$6,560
Late Filing Penalty	\$0	\$2,259	\$1,640
Substantial Understatement	\$3,636	\$2,259	\$1,640

In addition to the principal due and penalties enumerated above for the three tax years,

DRA shall calculate the applicable RSA 21-J:28 interest on the principal due for each year.

DRA shall submit a certification of such interest calculation to the Taxpayer, copying the board, within 10 days of the clerk's date on this decision including a per diem rate to facilitate calculation and payment by the Taxpayer.

Findings of Fact and Rulings of Law

DRA submitted the following findings of fact and rulings of law. The board's responses are as follows.

In these responses, "neither granted nor denied" generally means one of the following:

- a. The request contained multiple requests for which a consistent response could not be given;
- b. The request contained words, especially adjectives or adverbs, that made the request so broad or specific that the request could not be granted nor denied;
- c. The request contained matters not in evidence or not sufficiently supported to grant or deny;
- d. The request was irrelevant; or
- e. The request is specifically addressed in the decision.

Findings of Fact

1. Granted.
2. Granted.
3. Neither granted nor denied.
4. Granted.
5. Granted.

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6. Granted.

7. Granted.

8. Granted.

9. Granted.

10. Granted.

11. Granted.

12. Granted.

13. Granted.

14. Granted.

15. Granted.

16. Granted.

17. Granted.

18. Granted.

19. Granted.

20. Granted.

21. Granted.

22. Granted.

Rulings of Law

1. Granted.

2. Granted.

3. Granted.

4. Granted.

5. Granted.

6. Granted.
7. Granted.
8. Granted.
9. Granted.
10. Denied.
11. Granted.
12. Denied.
13. Granted.
14. Denied.
15. Denied.
16. Granted.
17. Denied.
18. Neither granted nor denied.
19. Denied.
20. Denied.
21. Denied.

Rehearing

A motion for rehearing, reconsideration or clarification (collectively "rehearing motion") of this decision must be filed within thirty (30) days of the clerk's date below, not the date this decision is received. RSA 541:3; TAX 201.37. The rehearing motion must state with specificity all of the reasons supporting the request. RSA 541:4; TAX 201.37(b). A rehearing motion is granted only if the moving party establishes: 1) the decision needs clarification; or 2) based on the evidence and arguments submitted to the board, the board's decision was erroneous in fact or

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in law. Thus, new evidence and new arguments are only allowed in very limited circumstances as stated in board rule TAX 201.37(e). Filing a rehearing motion is a prerequisite for appealing to the supreme court, and the grounds on appeal are limited to those stated in the rehearing motion. RSA 541:6. Generally, if the board denies the rehearing motion, an appeal to the supreme court must be filed within thirty (30) days of the date on the board's denial.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

Paul B. Franklin, Chairman

Douglas S. Ricard, Member

Steven H. Slovenski, Esq., Member

Certification

I hereby certify that a copy of the foregoing decision has this date been mailed, postage prepaid, to Francis J. Dineen, CPA, Agent for Ralph Sweatt, Taxpayer; and Kathleen J. Sher, Esq., Department of Revenue Administration.

Date: November 19, 1999

Lynn M. Wheeler, Clerk

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