

**David and Barbara Somero**  
v.  
**Department of Revenue Administration**  
**Docket No.: 20725-05ID**

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**Paul and Jayne Somero**  
v.  
**Department of Revenue Administration**  
**Docket No.: 20726-05ID**

**DECISION**

The “Taxpayers” appeal, pursuant to RSA 21-J:28-b, the assessment of a RSA 77:4 tax on dividends by the department of revenue administration (“DRA”). The amount in dispute is a tax of \$633,530.27 and a (“reduced”) interest assessment of \$170,414.57 (as stated on page 2 of the DRA’s June 8, 2005 “Final Order”). The board has consolidated these appeals for hearing and decision because they involve the same facts and legal issues.

These “de novo” appeals are governed by RSA 21-J:28-b, IV which gives the board jurisdiction to determine the “correctness” of the DRA’s determinations. The Taxpayers have the burden of proof by a preponderance of the evidence. See TAX 209.04 and 201.27(f) (also cited in requested Ruling of Law 1 infra). The board finds the Taxpayers failed to meet this burden.

The Taxpayers argued the DRA's determination was incorrect because:

- (1) while they individually received substantial cash in connection with certain transactions involving their company, Somero Enterprises, Inc. ("Enterprises"), the cash should not be treated as dividends but as a return of capital because it was generated by the transfer of 80.5 % of their ownership interest in Enterprises to a third party, Summit Partners ("Summit");
- (2) the form of the transactions, which involved creation of another corporation, Somero Holding, Inc. ("Holding"<sup>1</sup>) and a sale of "goodwill" that allowed Enterprises to achieve a "stepped-up basis" in amortizable assets for federal income tax purposes, does not mean the cash received by the Taxpayers (as shareholders in Holding following that sale and income recognition) should result in liability under the New Hampshire interest and dividends tax because "[t]here is no inconsistency between treating the transaction as an asset sale for Federal purposes and as a stock sale for New Hampshire purposes" (see Taxpayer Exhibit No. 1, "Brief" p. 2);
- (3) Holding was formed "for the sole purpose of accomplishing the sale of Enterprises stock to Summit in a manner that allowed for a stepped-up basis in the Enterprises assets," Holding was "merely a transitory step in the sale" and the "Cash Proceeds" (\$23,474,000) received by the Taxpayers were either a payment "by way of liquidation, redemption or otherwise" under RSA 77:4-c or, alternatively, payments for the sale of their stock not subject to the interest and dividends tax (Brief, pp. 4 – 7); and
- (4) the cash received is not subject to tax under RSA 77:4.

The DRA argued its determination of tax liability was correct because:

- (1) federal and state tax liability issues are distinct and do not necessarily require the same outcomes;

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<sup>1</sup> In the Brief and in other documents, this entity is sometimes referred to as "Holdings."

- (2) from the tax returns and other documents submitted, it is clear that Holding reported substantial income in 1997 and made cash distributions to the Taxpayers in that year;
- (3) these cash distributions meet the definition of taxable dividends contained in RSA 77:4 and REV 901.07, 903.05 and 903.06; and
- (4) the Taxpayers cannot meet their burden of proving the DRA's determination of tax liability was incorrect.

### **Board's Rulings**

The board finds the Taxpayers did not meet their burden of proving the incorrectness of the DRA's determinations regarding the RSA 77:4 dividends tax and the appeals are therefore denied. The board's findings are presented below.

The parties are in agreement regarding most of the facts pertaining to these transactions, but disagree on some of the interpretations to be drawn for the purposes of the RSA 77:4 dividends tax. (This is evidenced in part by a lack of objection, at the hearing held by the board on February 21, 2006, to the majority of the findings of fact and the rulings of law requested by the DRA and included at the end of this Decision.)

The appeals pertain to certain carefully structured corporate and shareholder transactions that occurred in 1997 that included the formation of a new corporation (Holding), a cash transfer from a third party (Summit) to acquire a majority ownership interest (80.5%) in the Taxpayers' company (Enterprises), and cash received by the Taxpayers from Holding. The central issue is whether the cash received, detailed below, is taxable as dividends under RSA 77:4.

In the Brief, the Taxpayers candidly acknowledge the creation of Holding and the structuring of the transactions were planned and intended to achieve certain valuable federal income tax benefits, notably a "stepped-up basis" in corporate "goodwill" and the ability to amortize that goodwill over a 15-year period.

These benefits were of material importance both to Summit, who purchased a controlling interest (80.5%) in the company owned by the Taxpayers, and to the Taxpayers themselves, who continued to have ongoing (but reduced) ownership interests in that company. The parties appear to agree that if the transaction had been structured differently, such as, for example, a sale of the Enterprises common stock owned by the Taxpayers to Summit, no interest and dividends tax liability would have been incurred. Such a transaction, however, would not have resulted in the benefits of a stepped-up basis and goodwill amortization over time (as an offset to otherwise taxable corporate income). As stated on page 1 of “Attachment to Section E (Reason For Appeal)” of the Taxpayers’ appeal documents filed with the board, these benefits were “a function of special Federal income tax rules.”

Nonetheless, the board cannot accept the Taxpayers’ argument that their “intentions” should be accommodated for purposes of the New Hampshire tax, rather than the actual transactions planned and structured by their advisers and agreed to by them to take advantage of those “special Federal income tax rules.” The Taxpayers’ advisers included knowledgeable tax accountants and lawyers who appear to have focused their planning more on federal tax issues than on the liability of the Taxpayers for New Hampshire’s RSA 77:4 dividends tax. In other words, they could have structured the transaction as a simple purchase and sale of stock in Enterprises between Summit and the Taxpayers, but elected not to do so because of what they concluded were less desirable federal income tax consequences.

There is no question the Taxpayers received substantial cash payments from Holding in 1997 and that Holding reported income in excess of the amounts paid to them in that year. Taxpayer David W. Somero received \$11,058,391 and Taxpayer Paul Somero received \$9,240,235, according to Holding’s 1997 federal income tax return, and this company reported a sale of “goodwill” for \$23,474,000 and income of \$24,205,613 in that document. (See Findings

of Fact #s 12, 13, 11 and 10, infra, and the tax return included as part of DRA Exhibit No. C.)

The DRA's rules define dividends to include a distribution of "property" (which can include cash, as in this case) to shareholders ("with respect to their ownership interest") from either current year profit or the "[a]ccumulated profits of that entity" – "other than in liquidation of the organization." See REV 901.07 and 903.05 ("Deemed Dividends"); see also RSA 77:7, which exempts from the tax on "dividends" specified in RSA 77:4, IV, a "distribution of capital," but expressly provides that "accumulated profits shall not be regarded as capital."<sup>2</sup>

Holding did not file any plan of liquidation in 1997<sup>3</sup> and was not actually liquidated until two years later (1999), which are facts of some relevance. Nor was there evidence presented that the cash distributions were made by Holding in redemption of the Taxpayers' stock.<sup>4</sup> The mere fact the Taxpayers could have liquidated Holding earlier or have Holding prepare a plan of liquidation in 1997 to help confirm their "intentions," but did not do so, is not persuasive. In general, taxpayers can make a number of discretionary elections under federal and state law and whether they elect to do so can lead to tax benefits in some instances and tax liabilities in others. To overlook a failure to make such an election for some purposes and not others, however, would be inconsistent as well as illogical.

The board finds the cash proceeds received by the Taxpayers can be attributable to the income generated and recognized by Holding on its income tax returns. Holding received the bulk of its income by selling goodwill to Enterprises. While Holding and Enterprises were

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<sup>2</sup> It is undisputed that neither Holding nor Enterprises made a "declaration of distribution of capital" in their 1997 tax returns. (See Findings of Fact #s 14, 15 and 17, infra.) Cf. RSA 77:4, IV, which requires the taxability of "Dividends, other than that portion of a dividend declared by corporations to be a return of capital and considered by the federal internal revenue service to be such, the exemption of which is permitted by RSA 77:7."

<sup>3</sup> See Finding of Fact # 16, infra.

<sup>4</sup> As noted on page 11 of the DRA's Final Order, the Taxpayers "did not exchange their Holding[] stock for the distribution. It was not a redemption or similar to a redemption because a redemption refers to buying property back. Holding[] did not buy its stock back in the transaction."

admittedly related parties, these transactions were structured as they were (rather than in a simpler fashion) in order to achieve the valuable federal income tax benefits noted above. To honor the form of these more complex transactions for federal tax purposes and ignore them for state tax purposes is not warranted.

The board has carefully reviewed the legal arguments and authorities cited by the Taxpayers, including those presented at the hearing and in the Brief. In essence, the Taxpayers argue the board should overlook the “technical” details of how the transactions were structured and focus entirely on the Taxpayers’ “intentions” to “sell the stock of Enterprises.” They also emphasize the material transactions occurred within a span of 44-days (January 15 – February 28) after Holding was formed in 1997 and that Holding was kept in existence until 1999 only to allow receipt of the final installments of the purchase price from Summit which occurred in that year. These arguments, however, and the federal and U.S. Tax Court case authorities cited in support of them, do not allow the board to conclude the DRA’s determination of the RSA 77:4 dividends tax was incorrect.

The Taxpayers’ authorities and reasoning rest on cases interpreting federal corporate and individual income tax statutes, not state tax law, as embodied in the New Hampshire statutes and regulations cited by the DRA, regarding the recognition of dividend income. In Olmsted v. Commissioner, T.C. Memo 1984-381 (1984), for example, the issue concerned Internal Revenue Code Section 331 and whether the taxpayers were entitled to treat a distribution as a tax-free exchange “in complete liquidation” of a corporation under that section or as a dividend taxable as ordinary income under Section 301. In Zenz v. Quinlivan, 213 F.2d 914 (1954), an older case from the Sixth Circuit, the court did not look beyond the form of the transactions structured by the taxpayer. In Zenz, the court agreed with the taxpayer’s reliance on “Section 115(c) of the Internal Revenue Code” and treasury regulations then in effect to rule a stock “redemption which

completely extinguishes the taxpayer's interest in the corporation" and the taxpayer "does not retain any beneficial interest whatsoever . . . is not equivalent to the distribution of a taxable dividend as to him." Id. at 917. Here, the distribution was not a redemption of the Taxpayers' stock in Holding and did not extinguish either their actual ownership or beneficial interest in the company.

More to the point are the actual documents filed by Holding and Enterprises. As noted above, Holding's 1997 tax return shows recognition of \$23,474,000 of income from the sale of goodwill (to Enterprises). Enterprises' 1997 tax return, for its part, recognized the acquisition of an asset of \$24,200,000 amortizable over 15 years and recorded an amortization expense of \$1,344,444 (a deduction from otherwise taxable income) in that year. (See Enterprises' 1997 Form 4562, Part VI, included in DRA Exhibit C.) Contrary to the arguments presented by the Taxpayers, the board cannot dismiss these filings made "under penalties of perjury" simply as a "fiction" relevant only to federal tax law. Cf. Brief, p. 2.

In summary, the board finds the Taxpayers failed to prove the DRA's determination of RSA 77:4 dividends tax was incorrect. The appeals are therefore denied. Below are the board's responses to the DRA's requests for findings of fact and rulings of law, followed by a summary of procedures necessary for requesting a rehearing and appeal of this Decision.

#### DRA's Requests for Findings of Fact and Rulings of Law

The DRA's requests are replicated in the form submitted and without any typographical corrections or other changes. The board's responses are in bold face. 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 overly broad or narrow so that the Request could not be granted or 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. Prior to January 15, 1997, the Petitioners were majority shareholders of Somero Enterprises, Inc. (02-0399312).

**Granted.**

2. On January 8, 1997, Somero Holding Co. (04-3348564) was incorporated in the State of Delaware, and the Petitioners served as directors of the corporation. See Certificate of Incorporation of Somero Holding Company.

**Granted.**

3. On January 15, 1997 the Petitioners contributed 100% of their shares in Somero Enterprises, Inc. (02-0399312) to Somero Holding Co. (04-3348564) resulting in Somero Enterprises, Inc. becoming a wholly owned subsidiary of Somero Holding Co. See Unanimous Consent in Lieu of a Meeting of the Board of Directors.

**Granted.**

4. On January 15, 1997, the Petitioners became majority shareholders in Somero Holding Co. (04-3348564), and acquired said shares “for investment and not with a view to the sale or distribution thereof.” See Subscription to the Board of Directors.

**Granted.**

5. Summit Venture Partnership contributed approximately \$24,200,000 worth of capital to Somero Enterprises, Inc. (02-0399312).

**Granted.**

6. On February 28, 1997, Somero Enterprises, Inc. (04-3355950) redeemed shares from Somero Holding Co. (04-3348564) for approximately \$24,200,000. See Somero Enterprises, Inc. Stock Purchase and Redemption Agreement, §2.1. and page 2 of Somero Holding Company of Special Meeting of the Board of Directors Held February 24, 1997.

**Granted.**

7. Summit Venture Partnership received shares representing 80.5% ownership in Somero Enterprises (02-0399312).

**Granted.**

8. Because Somero Enterprises, Inc. (02-0399312), an S corporation with previously elected QSSS status, may not be owned by a partnership, it was reformed as a new C corporation, Somero Enterprises, Inc. (04-3355950).

**Neither granted nor denied.**

9. Somero Enterprises, Inc. (04-3355950) amortized \$24,200,000 for the purchase of Goodwill pursuant to I.R.C §197. See Enterprises (04-3355950) tax return line 40.

**Denied.**

10. Somero Holding Co. (04-3348564) reported income of \$24,205,613 for 1997. See Holding's (04-3348564) Federal Schedule K, line 23.

**Granted.**

11. The 1997 Federal return of Somero Holding Co. (04-3348564) contained form 4797 showing the sale of Goodwill in the amount of \$23,474,000.

**Granted.**

12. Petitioner, David W. Somero, received a distribution in the amount of \$11,058,391. See K-1 for David W. Somero, line 5, from Somero Holding Co. (04-3348564) 1997 Federal return.

**Granted.**

13. Petitioner, Paul Somero, received a distribution in the amount of \$9,240,235. See K-1 for Paul Somero, line 5, from Somero Holding Co. (04-3348564) 1997 Federal return.

**Granted.**

14. Somero Holding Co. (04-3348564) made no declaration of distribution of capital with its 1997 tax return.

**Granted.**

15. Somero Enterprises, Inc. (04-3355950) made no declaration of distribution of capital with its 1997 tax return.

**Granted.**

16. Somero Holding Co. (04-3348564) did not file a plan of liquidation or a Federal Form 966 Corporate Dissolution or Liquidation for the 1997 tax year.

**Granted.**

17. The distributions to the Petitioners from Somero Holding Co. (04-3348564) were not declared to the Federal Internal Revenue Service to be capital distributions. See RSA 77:4, IV.

**Granted.**

18. The distributions to the Petitioners are from Somero Holding Co.'s (04-3348564) 1997 current year's profits. See Rev 903.06

**Neither granted nor denied.**

19. Petitioners received dividends from Somero Holding Co. (04-3348564) within the meaning, and within the scope of taxation, of RSA 77:4, IV.

**Neither granted nor denied.**

20. Petitioners received dividends from Somero Holding Co. (04-3348564) within the meaning of Rev 901.07, and within the scope of taxation of Rev 903.05.

**Neither granted nor denied.**

Ruling of Law

1. The Petitioner has the burden of proof to establish his or her case by a preponderance of the evidence. Dunlop v. Daigle, 122 N.H. 295, (1982). See also Tax 209.04 and Tax 201.27(f).

**Granted.**

Further Proceedings

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

in law. Thus, new evidence and new arguments are only allowed in very limited circumstances as stated in board rule TAX 201.37(f). 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

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Michele E. LeBrun, Member

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Douglas S. Ricard, Member

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Albert F. Shamash, Esq., Member

**Certification**

I hereby certify a copy of the foregoing Decision has this date been mailed, postage prepaid, to: Kenneth R. Goldberg, Esq., Brown Rudnick, One Financial Center, Boston, MA 02111, Taxpayers Representative; and Michael R. Williams, Esq., State of New Hampshire Dept. of Revenue Admin., 45 Chenell Drive, PO Box 457, Concord, NH 03301, DRA Counsel.

Date: 5/11/06

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Anne M. Stelmach, Clerk