

NOW OR NEVER? WHY LLC OWNERS SHOULD CONSIDER FILING A CLAIM FOR REFUND BEFORE IT'S TOO LATE

By: Justin T. Vartanian, Esq.
Email: jvartanian@devinemillimet.com
Phone: 603.695.8635

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If any of your clients are organized as limited liability companies, then chances are they are well aware of the new "LLC tax" that went into effect in July 2009. This so-called LLC tax was included in a budget bill last June at the eleventh hour, based on a suggestion contained in a letter from the Department of Revenue Administration (the "Department") to the Budget Bill Conference Committee. The amendment redefined the term "dividend" to include distributions from all LLCs, thus subjecting LLC owners to the five percent tax on interest and dividends for all distributions from the LLC beyond a "reasonable compensation" deduction under the Business Profits Tax for services provided by the members to the LLC and to the extent of accumulated earnings. What your clients may not be aware of, however, is that time is running out on an opportunity to preserve their right to a refund if the tax is declared unconstitutional.

While the business community has been outspoken in its call for repeal, the support within the state legislature to repeal the tax is questionable. For example, Senate Bill 497, which would have repealed the tax and relied on federal standards to set the state compensation deduction, easily passed through the Senate before stalling in the House. While several other legislative bills that would repeal the tax have been introduced, at the moment only SB 450 contains language to remove the LLC tax provisions and return the language in the Interest & Dividends Tax to the language in effect prior to the adoption of Chapter 144 of the Laws of 2009. With the state's budget woes, even Governor Lynch's public support has been insufficient in getting repeal language actually enacted into law. Both the House Ways & Means and House Finance Committees currently appear to support the repeal of the LLC tax as it appears in the amendment to SB 450 but the

Tax Practice Group *Federal, State & Local*

**Jon Sparkman, Esq., CPA,
Chair**
603.695.8507
jsparkman@devinemillimet.com

Steven Cohen, Esq., CPA, LLM
603.695.8504
scohen@devinemillimet.com

Alexander J. Walker, Esq.
603.695.8553
awalker@devinemillimet.com

**Maurice P. Gilbert, CPA, MST
Director of State Taxation**
603.695.8612
mgilbert@devinemillimet.com

Anu R. Mullikin, Esq., LLM
603.695.8536
amullikin@devinemillimet.com

Pat C. McHugh, Esq., CPA
603.695.8572
pmchugh@devinemillimet.com

Daniel Will, Esq.
603.695.8554
dwill@devinemillimet.com

Nicholas Forgione, Esq., LLM
978.475.9100
nforgione@devinemillimet.com

Patricia M. McGrath, Esq., LLM
603.695.8537
pmcgrath@devinemillimet.com

Jason E. Cole, Esq., CPA
603.695.8566
jcole@devinemillimet.com

Harper R. Marshall, Esq.
603.695.8645
hmarshall@devinemillimet.com

Justin T. Vartanian, Esq.
603.695.8635
jvartanian@devinemillimet.com

DEVINEMILLIMET.COM

TAXENEWS@DEVINEMILLIMET.COM

repeal must still be passed by the House of Representatives and the Senate before it reaches the Governor for his signature. The amendment to SB 450 would not eliminate the tax on calendar year 2009 distributions.

A lawsuit challenging the constitutionality of the LLC tax was filed in early January against the New Hampshire Department of Revenue Administration in Hillsborough County Superior Court (Docket No. 10-E-0048). The petition specifically alleges several violations of the New Hampshire Constitution. First, the petition claims that the tax violates equal protection because similarly situated taxpayers are treated differently by the tax, citing the example of an owner of real estate holding the property in an LLC as compared to an owner of real estate holding the property in a different manner. Second, the petition claims that the tax is impermissibly vague and indefinite in violation of due process protections because the legislature did not define the subject to be taxed or articulate the process by which a definition would be constructed. Third, the petition claims that the law is unconstitutionally retrospective because it applies a taxing provision to a transaction that occurred before its enforceable date, citing Cagan's Inc. v. New Hampshire Dep't of Rev. Admin., 126 N.H. 239 (1985) for support.

While this matter is unlikely to be resolved in the near future, it is relevant to LLC owners *now* because of New Hampshire's unique limitations on claims for refunds. In 1990, the United States Supreme Court held that while a state must provide taxpayers with a procedure for challenging the constitutionality of a tax either before or after it is due, there is no bright line rule requiring states to allow taxpayers to obtain a refund for any specific period of time when a state tax provision is found unconstitutional. See McKesson Corp., v. Division of Alcohol Beverages and Tobacco, 496 U.S. 18 (1990). Based on this holding, New Hampshire added a provision in 1994 which provided taxpayers with just **one hundred and twenty(120) days** from the **due date of a tax**, in most cases April 15, 2010, to file a claim for refund on the basis that it is unconstitutional. See RSA § 21-J:29 I,(d). As compared to the general statute of limitations applicable to a claim for refund, which is three years from the due date of the tax on which the refund is claimed or two years from the date the tax was actually paid, whichever is later, the period for filing based on constitutional grounds is extremely short. See RSA § 21-J:29 I.

Because New Hampshire taxpayers have such a short window of opportunity in which to file a claim for a refund based on the unconstitutionality of the LLC tax, it is doubtful the case against the Department will be resolved before the time for filing such a claim expires. While legislative efforts still may succeed in repealing the tax, Governor Lynch has made it clear that he will not support any

Office Locations:

111 Amherst Street
Manchester, NH 03101
T 603.669.1000
F 603.669.8547

300 Brickstone Square
Andover, MA 01810
T 978.475.9100
F 978.470.0618

43 North Main Street
Concord, NH 03301
T 603.226.1000
F 603.226.1001

legislation which makes repeal of the tax retroactive. Accordingly, filing a claim for refund is likely a taxpayer's only hope to recoup a portion of the interest and dividends taxes paid in 2009.

We will continue to monitor the petition filed against the Department as well as the legislative efforts aimed at repealing the LLC tax. Because neither appears likely to be resolved in the near future, however, you should consider whether your clients would benefit from filing a protective claim for refund before the statute of limitations expires in order to preserve their rights in the event that the tax is found unconstitutional. There is no way to know whether or not the Department will deny each claim, thus requiring that the taxpayer commence the appeal process, or simply suspend the matters pending a resolution of the current case. At the very least, your clients should be made aware of the pending lawsuit and the short timeframe in which to file a claim for refund so that they do not inadvertently miss out on an opportunity to obtain a refund if the challenge is successful.

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