

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

TOWE FARMS, INC.,)	
)	DOCKET NO: CT-1998-6
Appellant,)	
)	
-vs-)	
)	FACTUAL BACKGROUND,
THE DEPARTMENT OF REVENUE)	CONCLUSIONS OF LAW,
OF THE STATE OF MONTANA,)	ORDER AND OPPORTUNITY
)	<u>FOR JUDICIAL REVIEW</u>
Respondent.)	

By order dated July 16, 1999, the Board set forth a briefing scheduling for the above-entitled appeal. Upon receipt of all briefs in a timely fashion, the parties requested the opportunity to present oral arguments to supplement the arguments raised in the briefs.

Oral arguments were held on the above-entitled appeal in Billings, Montana on November 16, 1999 in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the oral arguments was duly given as required by law.

The taxpayer, represented by Attorney Thomas E. Towe, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Attorney Brenda Gilmer and Revenue Agent Brian Staley, presented testimony in opposition to the appeal. Testimony was presented and exhibits were received. The

Board allowed the record to remain open for a period of time for the purpose of allowing the taxpayer to respond to Board Exhibit Number One. Having received the taxpayer's post-hearing response in a timely fashion, the Board then took the appeal under advisement; and the Board, having fully considered the testimony, exhibits, post-hearing submission, and being well and fully informed in the premises, finds and concludes as follows:

STATEMENT OF THE ISSUE

The taxpayer disputes a December 25, 1997 assessment for Towe Farms, Inc., for the years ended December 31, 1992-1996. The taxpayer raises three issues on appeal: capital losses should be carried over as provided in the federal Internal Revenue Code; the subject audit assessment should take into account claimed adjustments under amended federal income tax returns; amended Section 15-31-509 MCA (1997), which provides for a three, rather than a five, year period for assessment and refund, should be applied retroactively to tax years 1992 and 1993 rather than only to post-amendment tax years.

FACTUAL BACKGROUND

The parties stipulated and agreed upon the following facts:

1. Towe Farms, Inc. (hereinafter "Taxpayer") timely filed tax returns for the year 1992, 1993, 1994, 1995 and 1996.
2. On April 30, 1994, Taxpayer filed amended returns

for 1988, 1989, 1990 and 1991.

3. Taxpayer was not notified by DOR prior to Assessment Letter of December 25, 1997, that these amended returns would not or should not be accepted by DOR or that the DOR questioned the returns or any of their content.

4. Taxpayer has not waived the statute of limitations for tax years 1991, 1992, 1993, 1994, 1995 or 1996, nor has there been any assessment by the Internal Revenue Service of the U.S. Treasury, nor has there been a petition filed with the U.S. Tax Court, nor has there been a decision by the U.S. Tax Court regarding any of these years.

5. On December 24, 1997, the DOR made an assessment of taxes against the Taxpayer as follows:

1992	\$7,611 + interest
1993	\$4,029 + interest
1994	\$ 113 + interest (+\$11.30 late payment penalty)
1995	\$8,987 + interest
1996	\$6,793 + interest

6. If the capital loss carryovers claimed by the Taxpayer for each of the years involved were allowed, there would be no assessments or amounts due for any of the years 1992 through 1996.

7. In the event the capital loss carry-overs are disallowed, the Taxpayer claims the DOR has not given it credit

for net operating loss carryovers of \$1,486 for 1990 and \$3,029 for 1991 as a result of amended returns filed on April 30, 1994. If the amended returns are valid and are given full effect, the DOR does not dispute the accuracy of the amounts.

TAXPAYER'S CONTENTIONS

The taxpayer insists that the calendar years 1992 and 1993 are beyond the statute of limitations. Towe Farms timely filed all of its tax returns for the years 1992-1996. On April 30, 1994, Towe Farms timely filed amended returns for 1988, 1989, 1990 and 1991. At no time prior to April 30, 1997, was any notice received by Towe Farms that the DOR did not intend to give the amended returns full force and effect. The three year statute of limitations, prescribed by Section 15-31-509 (1), MCA, expired on April 30, 1997, well before the subject assessment under contention was dated (December 25, 1997). Therefore, Towe Farms must prevail with regard to any taxes and interest claimed for 1992 and 1993.

The subject assessment came as a result of the DOR's disallowance of capital loss carry-over for Towe Farms. Montana law does not expressly disallow a capital loss carry-over for a corporation, and it is clearly recognized under the federal Internal Revenue Service code for corporations. The DOR's position is based upon an erroneous interpretation of Section 15-31-114 (b) (i), MCA. The DOR's position is supported by a rule

DOR has promulgated (ARM 42.23.411) which the taxpayer also asserts is contrary to statute and applicable law. Further, the capital loss carry-over is not a "deduction" but an "offset" against gross income and, therefore, Section 15-31-114 does not apply. The section that does apply is the section that defines gross income, namely, Section 15-31-113.

Finally, the taxpayer insists that full credit has not been given to the amended returns filed on April 30, 1994, which showed an overpayment for each of the years 1988 through 1991. The parties agree that if Towe Farms loses both of the first two issues, all the items claimed in the original returns and the amended returns have been accounted for except \$1,486 in 1990 and \$3,029 in 1991. Both of these sums are net operating losses which, under Section 15-31-119, Towe Farms may carry over to 1992. Since the taxpayer has never been notified that the amended returns were not valid or properly accepted, and since the statute of limitations on those amended returns expired on April 30, 1997, approximately eight months before the subject assessment, the taxpayer contends that Towe Farms should receive full credit for these overpayment amounts if it is not successful on issues #1 and #2.

DEPARTMENT OF REVENUE'S CONTENTIONS

The DOR response to the taxpayer's three issues on appeal are as follows:

1. Regarding the adjustment made by the DOR to deny the capital loss carryover claimed on the taxpayer's Montana Corporate License Tax returns for the years of the subject assessment, Section 15-31-114 (1) (b) (i), provides that all losses actually sustained and charged off within the year and not compensated by insurance or otherwise must be taken in the year incurred. Capital losses must be taken in the year incurred and cannot be carried forward or backward under Montana law. Therefore, the capital loss carryovers claimed on the taxpayer's Montana Corporation License Tax returns for the years 1988-1993 and 1995-1996 were denied.

2. Regarding the issue as to whether or not the taxable years ending December 31, 1993 are beyond the statute of limitations under Section 15-31-509, MCA, the DOR determined that the 1997 legislative amendment, which reduced from five to three years the period for assessment and refund, does not apply retroactively. The 1997 amendment only applies to tax returns filed on or after March 13, 1997, the effective date of the amendment. As a general rule, statutes are to be applied prospectively from the date they become effective. Section 1-2-109, MCA, specifically provides that no law in Montana's statutes is retroactive unless it is expressly so declared. Applying the new statute of limitations to the Department's right to assess taxpayers under the prior statute would take away a right that

existed under the prior law. Therefore, this would be a retroactive application of a statute and is impermissible unless expressly declared retroactive by the Montana Legislature. An examination of Section 15-31-509, MCA, reveals no declaration by the Legislature that the new statute of limitations was intended to be applied retroactively to tax years that were open for assessment under the existing law.

In addition, an examination of the session law containing the amendment at issue reveals the Legislature provided for retroactive applicability of certain sections of the bill, but not the section amending Section 15-31-509, MCA. (Montana Sessions Laws, 1997, ch.51). This is strong support for the proposition that the Legislature did not intend the amendment to Section 15-31-509, MCA, to apply retroactively. It is the division's determination that the taxable years ending December 31, 1992 and December 31, 1993 are still within the statute of limitations to assess.

3. Regarding the overpayments claimed on the taxpayer's 1992 Montana Corporation License Tax return, the DOR determined that these overpayments resulted from Amended Montana Corporation License Tax returns filed for the years 1988-1991.

The amended Montana returns were filed as a result of some amendments reported on the taxpayer's 1120 returns. The amended federal returns were never acted upon by the Internal Revenue

Service and Towe Farms has never received any credit for any of the amended federal returns. If these returns were never acted upon by the Internal Revenue Service, then these changes cannot be accepted for Montana purposes either. No credit has been given on the 1992 Montana return as filed for the refund claims filed for the years 1988-1991. Therefore, no overpayment exists to carryover to 1993, 1994 or 1995. It is the DOR's determination that there are no valid overpayments to claim on the taxpayer's 1992 Montana return.

The DOR determined that the taxpayer owes an additional tax amounting to \$27,532 plus applicable interest for the years ended December 31, 1992-1996.

DISCUSSION

Regarding the first issue, the statute of limitations as it was impacted by the 1997 amendment, the Board finds in favor of the DOR. The amended statute of limitations, codified in Section 15-31-509, MCA, may not be applied to remove tax years from assessment if they were open for assessment under the prior statute.

A statute which takes away or impairs vested rights acquired under existing laws has been deemed by the Montana Supreme Court to be retroactive. Butte & Superior Mining Co. v. McIntyre, 71 Mont. 254, 229 P.730 (1924). Taking away the DOR right of assessment that existed under the prior law would

constitute a retroactive application of a statute and would not be permitted unless directly specified to be retroactive by the Montana Legislature.

On the second issue, regarding the taxpayer's contention that the DOR is mistaken in its interpretation of Section 15-31-114 (b) (i) in that this statute does not prevent a net capital loss carry-over for a corporation from being off set against current year's gross income, the Board finds in favor of the DOR.

Pursuant to Section 15-31-114 (1) (b) (i), all losses actually sustained and charged off within the year and not compensated by insurance or otherwise must be taken in the year incurred. The language of the statute is plain and unambiguous in its direction that all capital losses must be taken in the year incurred and cannot be carried forward or backward for Montana purposes.

On the third issue, that the DOR has failed to give Towe Farms full credit for a net operating loss carry-over from 1990 and 1991, which Towe Farms claimed by an amended return filed on April 30, 1994, the Board again finds in favor of the DOR. The taxpayer claims the DOR must recognize the amended returns despite the fact that the net operating loss deduction adjustments have not been allowed for federal income tax purposes. Section 15-31-506, MCA, requires corporations filing

amended federal income tax returns changing or correcting their taxable income to file amended state returns and corresponds with Section 15-31-509, MCA, providing for limitation provisions. ARM 42.23.303 provides that failure to file an amended return to correspond with an amended federal return extends the period of limitation for a deficiency assessment. The record indicates that the amended federal returns were never acted upon by the Internal Revenue Service and that Towe Farms has never received any credit for any of the amended federal returns. The DOR cannot determine the existence of a state overpayment or credit based upon a federal amended return until the federal adjustments are acted upon.

Section 15-31-119 (4), MCA, requires a net operating loss to be carried back to each of the three preceding taxable periods preceding the taxable period of the loss and allows a net operating loss for any taxable period ending after December 31, 1975 to be carried forward seven years.

CONCLUSIONS OF LAW

1. The Board has jurisdiction over this matter pursuant to Section 15-2-302 (1) (c), MCA
2. The subject income is subject to Montana Corporation License Tax under Section 15-31-101, MCA.
3. The amended statute of limitations, codified in Section 15-31-509, MCA, may not be applied to remove tax years

from assessment if they were open for assessment under the prior statute.

4. Section 15-31-114 (1) (b) (i), prescribes that all losses actually sustained and charged off within the year and not compensated by insurance or otherwise must be taken in the year incurred.

5. Section 15-31-119 (4), MCA, requires a net operating loss to be carried back to each of the three preceding taxable periods preceding the taxable period of the loss and allows a net operating loss for any taxable period ending after December 31, 1975 to be carried forward seven years.

6. The appeal of the taxpayer is hereby denied and the decision of the Montana Department of Revenue is hereby affirmed.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the taxes and interest assessed are properly due and owing.

DATED this 21st day of December, 1999.

BY ORDER OF THE
STATE TAX APPEAL BOARD

GREGORY A. THORNQUIST, Chairman

(S E A L)

JAN BROWN, Member

JEREANN NELSON, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 21st day of December, 1999, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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