

WD74900

**IN THE MISSOURI COURT OF APPEALS
WESTERN DISTRICT**

**JONATHAN D. EILIAN and
AMANDA A. EILIAN,**

Respondents (Petitioners below),

vs.

**DIRECTOR OR REVENUE
STATE OF MISSOURI**

Appellant (Respondent below)

**From the Administrative Hearing Commission of Missouri,
The Honorable Nimrod T. Chapel, Jr., Commissioner**

PETITIONER'S BRIEF

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ATTORNEYS FOR RESPONDENTS

TABLE OF CONTENTS

	<u>PAGE</u>
TABLE OF CONTENTS	i
STATEMENT OF FACTS.....	1
ARGUMENT	1
Standard of Review	1
Petitioner’s Brief	1
CONCLUSION	7
CERTIFICATION OF SERVICE AND COMPLIANCE	8

STATEMENT OF FACTS

With one exception, Respondents, Jonathan D. Eilian and Amanda A. Eilian, agree with Appellant's Statement of Facts set forth in Appellant's Brief. References to "Director" shall also mean "Appellant" and references to Eilians shall also mean "Respondents". The one exception involves the statement in the last paragraph that "the question in this case is whether the Eilians' NOL was properly utilized on 2006 and 2007 Missouri returns." (See Appellant's Brief, p. 9) In fact the Director's Final Decision dated November 2, 2009, which is the subject of this litigation, only relates to the 2006 tax year. Similarly the Administrative Hearing Commission ("Commission") found on January 23, 2012 that the Respondents are not liable for deficiencies on their 2006 Missouri individual income tax returns.

ARGUMENT

Standard of Review

With one exception, Respondents also agree with Appellant's Standard of Review discussion. The sole exception being the statement that the Commission's decision is not supported by the law and should be reversed in favor of the Director. In fact the Commission's decision that the Respondents are not liable for a deficiency on their 2006 Missouri individual income tax return is correct and should be affirmed.

Petitioner's Brief

Consistent with its prior position during the Commission proceedings, Appellant again tries to claim that Respondents are somehow receiving an impermissible double benefit for Missouri income tax purposes through its income tax filings. (See Appellant's

Brief, pp. 14 and 19). The Director states that the Commission's Final Decision failed to address this issue. (See Appellant's Brief, p. 19). In fact, the Commission found that the Eilians were not "double dipping" by claiming more in total deductions than the total amount of the net operating loss ("NOL"). (Final Decision, p. 12).

Appellant concedes that the Eilians properly carried forward their NOL from 2005 (\$34,535,832) to 2006. (See Appellant's Brief at p. 14) Instead the Director argues that the Respondents must make an adjustment to line one of their 2006 Missouri income tax return to prevent the Eilians from enjoying a double benefit. (See Appellant's Brief, p. 19).

The parties agree that pursuant to Section 143.181 RSMo. the starting point for the calculation of a nonresident individual's income is the individual's Missouri adjusted gross income, calculated as if he or she was a resident of Missouri. Pursuant to Section 143.121 RSMo., the Missouri adjusted gross income of a resident individual shall be the taxpayer's Federal adjusted gross income, subject to modifications in Section 143.121. A taxpayer's Federal adjusted gross income includes a deduction for a NOL carry forward. See 26 U.S.C. §172.

Section 172(b)(2) of Internal Revenue Code (hereinafter all references shall be "Code Section" only) sets forth the procedure to carryover an NOL to future tax years of the taxpayer. Pursuant to this provision, if a taxpayer does not use up a NOL, the taxpayer may carry the remainder of the NOL to the tax years following the NOL year. If the taxpayer does not use up the NOL in the first year following the NOL year, then it is to be carried forward to the next year. Code Sections §§172(b)(1)(A)(ii) and 172(b)(2).

As the Director points out, Section 172(b)(2) and Treasury Reg. Section 1.172-5 require that the taxpayer compute a modified taxable income for the taxable year to which the NOL is being carried. The Director traces the Respondents' calculation of their NOL for 2006 and seems to agree that the Respondents' Federal adjusted gross income was appropriately reported at (\$6,117,375). (Appellant's Brief at p. 16) Then Respondents correctly reported a combined Federal adjusted gross income of (\$5,993,836) on line one of their 2006 Missouri return. Consistent with the rules of Section 143.121.2(d), Respondents are not required to modify their Federal adjusted gross income for 2006, as 2006 is not the loss year (2005), nor is the loss being carried forward for more than 20 years or back for more than two years. The Director does not dispute that the Respondents correctly calculated their NOL for 2005 and the carryover to 2006 and 2007 on the Respondents' Federal income tax returns. But because the Respondents had a negative taxable income for 2006 due to the NOL carry forward, the Director claims that they should otherwise lose the ability to claim proper itemized deductions on their Missouri return. (Appellant's Brief at p. 18.) Once again the Director's position bears no statutory basis in Missouri law and, in truth, is illogical. As the Director points out, Missouri law permits a taxpayer to claim an itemized Missouri tax deduction for all Federal itemized deductions, except to the extent limited by Section 143.141. (Appellant's Brief at p. 15). The Director attempts to argue that the Respondents should lose Missouri itemized deductions totalling \$123,539, even though clearly not so limited by Section 143.141.

The Director states that the Respondents should have reported \$891,511 of income that was not taxed at the Federal level, but is taxable in Missouri. The Director offers no authority for this statement, as no such provision is included in the Internal Revenue Code, nor in Missouri statutes. The \$891,511 of income noted by the Director is not taxable in Missouri, as it represents non-Missouri source interest and United States Treasury interest which are not subject to Missouri income tax. The net positive Missouri modifications reported on the Respondents Missouri income return of \$891,511 are not taxable in Missouri because they are not from a Missouri source. The Director's claim that the Respondents used an additional \$891,511 of their NOL at the Missouri level makes no sense, as the \$891,511 was not taxable in Missouri.

The Director then claims that the Respondents reported excess Missouri itemized deductions in the amount of \$123,539, although acknowledging that "the Eilians reported the proper adjustments to Federal itemized deductions." (See Appellant's Brief, p. 18). Pursuant to Code Section 172, Respondents had investment income in 2006 which exceeded their itemized deductions, hence the Respondents can claim the full amount of their itemized deduction for purposes of reducing their Federal adjusted gross income and reducing the amount of NOL needed to reduce their taxable income to zero. In essence use of the properly claimed itemized deduction reduces the amount of NOL needed to zero out Respondents' taxable income for 2006. In her brief, the Director claims that an adjustment to the Respondent's Federal adjusted gross income is "warranted," once again failing to provide any statutory basis for such an add back. (Appellant's Brief at p. 19) If

the Director believes such an adjustment is warranted, it must seek a legislative solution, as existing law clearly does not provide this adjustment.

The Director next falls back to an argument, previously made, that the Supreme Court's opinion in Brown Group, Inc. v. Administrative Hearing Commission, 649 S.W.2d 874 (Mo. banc. 1983) stands for the proposition that the Supreme Court prohibited a taxpayer from benefitting twice for the same loss. For a number of reasons, the Director's continued reliance on Brown for this proposed addition to the Respondent's adjusted gross income must fail.

In Brown, a corporate taxpayer incurred a NOL in 1975 which was carried back in 1972 for Federal, but not Missouri purposes. The taxpayer did not carry the NOL back to 1972 for Missouri purposes, because at that time Missouri's taxable income was not defined by reference to Federal taxable income. The position of the taxpayer in Brown was that it should be entitled to utilize the NOL in 1975 for Missouri purposes and carried back to 1972 for Federal purposes. The Missouri Supreme Court reasoned that by carrying back the NOL for 1972 for Federal purposes, the taxpayer had to do the same for Missouri purposes, even though it would not receive any Missouri benefit for the NOL, due to the applicable Missouri law in effect at that time. In fact, the true holding of Brown, with very limited applicability, was that the amount entered into line one of the Missouri corporate income tax return, the taxpayer's Federal taxable income, could not be less than zero. Id. at 877.

The factual dissimilarities between this case and Brown make its holding clearly inapplicable in this instance. Brown involved a corporate taxpayer which carried back an

NOL and which tried to use the NOL in different years for Missouri and Federal purposes. In this instance, the Respondents are individuals, who have carried forward a NOL, which is being used consistently with the Federal and Missouri NOL carry forward periods. The Supreme Court's narrow holding that a corporation's Federal tax income cannot be less than zero for Missouri purposes does not apply in this instance either, which is evidenced by the fact that the Appellant has not contested the Respondents' 2005 Missouri tax return which reflects a negative Federal adjusted gross income (-\$33,786,344). The Director's argument that Brown should apply at all, simply has no basis under Section 143.121, nor any other provision of Missouri law.

Appellant's position is further weakened by the fact, that Brown was overruled in the legislature in 2004 by enactment of Section 143.431.5, which states in part, that "[f]or all tax years ending on or after July 1, 2002, federal taxable income may be a positive or negative amount." Appellant, acknowledging that Section 143.431.5 become Missouri law previously claimed that the new provision of law applies to federal taxable income for corporations only. What the Appellant fails to recognize is that the legislature's overruling of Brown, a case involving corporate taxpayer, also forecloses any chance the Appellant could claim that Brown should also apply to individual taxpayers, as the Appellant cannot continue to rely on a principle, which is based on a now invalid source, the Brown case.

Finally the Director proposes that Respondents' Federal adjusted gross income of (\$5,993,836) must be increased to \$6,117,375 again relying on Brown, which for the reasons described above is misplaced.

The Director's basis for reversing the Commission's holding is without merit. As previously described Brown is inapplicable to the present situation involving an individual taxpayer. In addition Brown has been overruled by the Missouri legislature. Finally the Director claims there is no Missouri statute that allow certain "offsets" which it claims Respondents enjoy. The Director is off base with this position, in that the Respondents have followed the statutory prescriptions set forth in Chapter 141 including the clear statutory language of Section 143.121.2(d) which provides the exclusive situations in which certain NOLs must be added back to Missouri adjusted gross income, none of which apply in this instance. The Director fails to provide one instance in which the Respondents reporting of their 2006 tax liability is inconsistent with existing Missouri law. Instead the Director relies on concepts and theories which are not part of existing Missouri law. The Director must seek legislative changes implementing the provisions of Missouri law that it seeks to rely on in this matter.

CONCLUSION

For these reasons this Court must affirm the decision of the Commission in favor of Respondents, Jonathan and Amanda Eilian.

Respectfully submitted,

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CERTIFICATION OF SERVICE AND COMPLIANCE

I hereby certify that on the 17th day of October, 2012, the foregoing brief was filed electronically via Missouri CaseNet and served electronically to:

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I further certify that the foregoing brief complies with the limitations contained in Rule No. 84.6(b) and that the brief contains 1,828 words.

/s/ Kent J. Lowry
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