

Summary of SC93075, Jonathan D. Eilian and Amanda Eilian v. Director of Revenue

On review from the administrative hearing commission, Commissioner Nimrod T. Chapel Jr. Argued and submitted March 6, 2013; opinion issued June 11, 2013

Attorneys: The director was represented by Trevor S. Bossert and Deputy Solicitor General Jeremiah J. Morgan of the attorney general’s office in Jefferson City, (573) 751-3321, and the Eilians were represented by J. Kent Lowry and Scott Hunt of Armstrong Teasdale LLP in Jefferson City, (573) 636-8394.

This summary is not part of the opinion of the Court. It has been prepared by the communications counsel for the convenience of the reader. It neither has been reviewed nor approved by the Supreme Court and should not be quoted or cited.

Overview: The director of revenue appeals the administrative hearing commission’s decision that a man and his wife did not underpay their 2006 Missouri taxes based on a 2005 net operating loss reflected in their federal taxes. In a unanimous decision written by Judge Paul C. Wilson, the Supreme Court of Missouri reverses the commission’s decision and remands (sends) back the case for the limited purpose of recalculating the couple’s 2006 Missouri tax liability in accordance with a prior opinion of this Court and relevant Missouri tax statutes.

Facts: Missouri taxpayer Jonathan Eilian in 2005 incurred a net operating loss (NOL) of more than \$34.5 million. Because he elected to waive a federal “carryback” provision that allows a taxpayer to offset the loss over certain years before the loss, section 172 of the federal code required him to use the NOL to offset his federal taxable income beginning the year following his loss, making his federal taxable income in 2006 less than the original amount of the NOL. Accordingly, he was required to use a portion of his NOL to bring his 2006 taxable income to zero and then use the remaining balance – a little more than \$6.1 million – to offset his federal taxable income in 2007. Under section 143.121.1, RSMo, the starting point for Eilian’s Missouri tax returns – his federal adjusted gross income – necessarily reflects the NOL reductions made in his federal taxable income in 2006 and 2007, giving him a Missouri tax benefit as well. Section 143.121, however, requires that certain modifications be made to the starting point for income that is taxable under Missouri law but not federal law.

The director of revenue determined that Jonathan Eilian and his wife underpaid their 2006 Missouri taxes because he improperly used his federal NOL from 2005 to offset income that was taxable under only Missouri law and not federal law. Eilian sought review from the administrative hearing commission, which ruled in Eilian’s favor. The director appeals.

REVERSED AND REMANDED.

Court en banc holds: (1) Because Eilian fails to persuade this Court that its long-standing precedent in *Brown Group Inc. v. Administrative Hearing Commission*, 649 S.W.2d 874 (Mo. banc 1983), should be abandoned, this Court reaffirms the holding in *Brown* and concludes it disposes of the legal issues in this case.

- (a) Because nothing in section 172 of the federal code authorized the taxpayer to use the NOL to offset Missouri-taxable income and because the state statute did not clearly authorize the taxpayer to circumvent section 172 by treating the loss as negative income and

using it as the starting point for its Missouri return, *Brown* held that the taxpayer was liable for the Missouri taxes relating to the taxpayer's "Missouri-taxable income," which is taxable under Missouri law but not federal law. Although *Brown* dealt with a corporate taxpayer, it applies to individual taxpayers as well – nothing in section 172 of the federal code distinguishes between individual and corporate taxpayers, nor is there any reason to allow individuals to use the NOL in a manner in which corporations cannot.

(b) *Brown* still is good law. Nothing in a subsequent legislative amendment to section 143.121 expressly purports to overrule or otherwise abrogate *Brown*, nor does it contradict *Brown*'s holdings. Further, the amendment did not occur until 2004 – more than 20 years after *Brown* was decided – weighing heavily against any argument that the amendment was intended to abrogate *Brown*. Additionally, the evident purpose of the new language was to restrict or even eliminate the Missouri tax benefits resulting from certain uses of a federal NOL.

(c) Eilian's NOL resulted in more than \$34.5 million in Missouri tax benefits precisely in the manner approved by *Brown*. But he then sought to use the negative income figure from his 2006 federal return created by this NOL to offset his 2006 Missouri-taxable income – precisely what was prohibited in *Brown*. Even though section 63(a) of the federal code permits a taxpayer's federal taxable income to be a negative amount for federal purposes, *Brown* held that the purpose of the statute at issue there would be served only if the word "income" were construed to mean amounts equal to or greater than zero – income that may be taxed. Otherwise, a taxpayer could incorporate a federal loss into its Missouri return by using a negative amount as its starting point, thereby using a federal NOL to offset Missouri-taxable income. Nothing in section 172 of the federal code or Missouri tax law suggests, let alone expressly authorizes, such a result. The Eilians' 2006 Missouri return failed to comply with section 143.121.1 when construed properly in accordance with *Brown*.

(2) The case is remanded to the commission for the limited purpose of performing a final calculation of the Eilians' 2006 Missouri taxes in accordance with this opinion.

(a) Under sections 143.111, RSMo, and 143.121, Eilian is allowed to reduce his Missouri adjusted gross income by the amount of his itemized federal deductions, with certain increases and decreases required by Missouri law. Nothing in *Brown* requires a contrary result.

(b) The director properly challenged the Eilians' 2006 return and was not limited to challenging only the 2007 return. *Brown* holds that a taxpayer's sole recourse with respect to an NOL is section 172 of the federal code, and nothing in that section nor Missouri law permits a taxpayer to use a federal NOL to offset Missouri-taxable income.

(c) When read carefully and in the context of its development, nothing in section 143.121.2(4) requires Eilian to add to or subtract from his Missouri returns for 2005, 2006 or 2007 as a result of his NOL. Even though a Missouri taxpayer still cannot reap any Missouri tax benefits for an NOL more than two years prior to a loss year, a 2003 amendment to section 143.121.2 allows the taxpayer to receive full federal tax benefits without forfeiting the Missouri tax benefits altogether.