

# Bill as Introduced

SB 125-FN-A - AS INTRODUCED

2011 SESSION

11-0212

09/10

SENATE BILL **125-FN-A**

AN ACT relative to the business profits tax deduction for reasonable compensation.

SPONSORS: Sen. Bradley, Dist 3; Sen. Barnes, Jr., Dist 17; Sen. Boutin, Dist 16; Sen. Bragdon, Dist 11; Sen. Carson, Dist 14; Sen. De Blois, Dist 18; Sen. Forrester, Dist 2; Sen. Forsythe, Dist 4; Sen. Gallus, Dist 1; Sen. Lambert, Dist 13; Sen. Luther, Dist 12; Sen. Morse, Dist 22; Sen. Rausch, Dist 19; Sen. Sanborn, Dist 7; Sen. Stiles, Dist 24; Sen. White, Dist 9; Rep. Chandler, Carr 1; Rep. Hess, Merr 9; Rep. Major, Rock 8; Rep. Tucker, Rock 17; Rep. Bettencourt, Rock 4

COMMITTEE: Ways and Means

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ANALYSIS

This bill modifies standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

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Explanation: Matter added to current law appears in **bold italics**.  
Matter removed from current law appears [~~in brackets and struck through~~].  
Matter which is either (a) all new or (b) repealed and reenacted appears in regular type.

STATE OF NEW HAMPSHIRE

*In the Year of Our Lord Two Thousand Eleven*

AN ACT relative to the business profits tax deduction for reasonable compensation.

*Be it Enacted by the Senate and House of Representatives in General Court convened:*

1 1 Purpose. The legislature finds that:

2 I. Small businesses are the lifeblood of the New Hampshire economy and are the most  
3 important source of jobs for residents of New Hampshire.

4 II. Recent increases in audits of small businesses in which small business owners are not  
5 allowed to deduct the full and fair value of their services to their small business in determining the  
6 business profits tax liability of the business have undermined New Hampshire's ability to provide a  
7 sound and encouraging environment for small business growth.

8 III. Good tax policy requires tax rules that provide taxpayers with clear guidance, encourage  
9 compliance, and enhance the competitiveness of our economy.

10 IV This act clarifies important business profits tax rules that apply to small businesses,  
11 eliminates costly and inefficient audits, and restores New Hampshire's ability to encourage small  
12 business growth and the good jobs these businesses create.

13 2 Reasonable Compensation Deduction. RSA 77-A:4, III is repealed and reenacted as follows:

14 III.(a) In the case of a proprietorship, partnership, or limited liability company filing a  
15 business profits tax return as a proprietorship, partnership, or limited liability company, a deduction  
16 equal to a fair and reasonable compensation for the personal services of a natural person who is a  
17 proprietor, partner, or member provided to the business organization, provided, however, that the  
18 amount of such deduction shall not exceed such business organization's gross business profits. The  
19 purpose of this paragraph is to permit a deduction from gross business profits of such a  
20 proprietorship, partnership, or limited liability company of all amounts that are fairly attributable to  
21 the personal services of the proprietor, partner, or member. Such amounts shall generally include all  
22 amounts reported as earned income on federal tax returns, but shall also include amounts  
23 attributable to personal services provided in connection with the operation and rental of real  
24 property, the sale of property and services, and other amounts due to services rendered.

25 (b) A taxpayer claiming a deduction under this paragraph shall bear the burden of  
26 proving that at least one or more proprietors, partners, or members provided actual services to the  
27 business organization at any time during the taxable period. Once a taxpayer has satisfied this  
28 burden of proof, the amount claimed as a deduction shall be presumed to be reasonable, unless the  
29 commissioner proves by a preponderance of the evidence that the deduction claimed by the taxpayer  
30 is grossly excessive.

31 3 Applicability. This act shall apply with respect to taxable periods ending after June 30, 2011.

32 4 Effective Date. This act shall take effect July 1, 2011.

LBAO  
11-0212  
12/20/10

**SB 125-FN-A - FISCAL NOTE**

AN ACT relative to the business profits tax deduction for reasonable compensation.

**FISCAL IMPACT:**

The Department of Revenue Administration states this bill will decrease state revenue by \$49,430,000 in FY 2012 and each year thereafter. There will be no fiscal impact on county and local revenue or state, county, and local expenditures.

**METHODOLOGY:**

The Department of Revenue Administration states this bill would transfer the burden of proof for the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships to the Department. The Department states this bill would make it responsible for proving whether a deduction taken for reasonable compensation is grossly excessive. The Department states this bill will make it difficult for it to dispute a taxpayer's compensation deduction because the Department does not have any information about the services rendered by the partnership or proprietorship. The Department states as a result, it would be ineffective to conduct an audit of a partnership or proprietorship to ensure compliance with the law.

The Department of Revenue Administration states partnerships and proprietorships paid \$49,430,000 in business profits taxes during tax year 2008. The Department assumes the bill would result in no partnerships or proprietorships being liable to pay the business profits tax and would result in a decrease in revenue by the same amount. The Department further states it can administer the law without any additional direct costs.

SB 125-FN-A - AS AMENDED BY THE SENATE

03/23/11 1158s

2011 SESSION

11-0212  
09/10

SENATE BILL ***125-FN-A***

AN ACT relative to the business profits tax deduction for reasonable compensation.

SPONSORS: Sen. Bradley, Dist 3; Sen. Barnes, Jr., Dist 17; Sen. Boutin, Dist 16; Sen. Bragdon, Dist 11; Sen. Carson, Dist 14; Sen. De Blois, Dist 18; Sen. Forrester, Dist 2; Sen. Forsythe, Dist 4; Sen. Gallus, Dist 1; Sen. Lambert, Dist 13; Sen. Luther, Dist 12; Sen. Morse, Dist 22; Sen. Rausch, Dist 19; Sen. Sanborn, Dist 7; Sen. Stiles, Dist 24; Sen. White, Dist 9; Rep. Chandler, Carr 1; Rep. Hess, Merr 9; Rep. Major, Rock 8; Rep. Tucker, Rock 17; Rep. Bettencourt, Rock 4

COMMITTEE: Ways and Means

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ANALYSIS

This bill modifies standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

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## STATE OF NEW HAMPSHIRE

*In the Year of Our Lord Two Thousand Eleven*

AN ACT relative to the business profits tax deduction for reasonable compensation.

*Be it Enacted by the Senate and House of Representatives in General Court convened:*

1       1 Purpose. The legislature finds that:

2           I. Small businesses are the lifeblood of the New Hampshire economy and are the most  
3 important source of jobs for residents of New Hampshire.

4           II. Recent increases in audits of small businesses in which small business owners are not  
5 allowed to deduct the full and fair value of their services to their small business in determining the  
6 business profits tax liability of the business have undermined New Hampshire's ability to provide a  
7 sound and encouraging environment for small business growth.

8           III. Good tax policy requires tax rules that provide taxpayers with clear guidance, encourage  
9 compliance, and enhance the competitiveness of our economy.

10          IV This act clarifies important business profits tax rules that apply to small businesses,  
11 eliminates costly and inefficient audits, and restores New Hampshire's ability to encourage small  
12 business growth and the good jobs these businesses create.

13       2 Reasonable Compensation Deduction. RSA 77-A:4, III is repealed and reenacted as follows:

14           III.(a) In the case of a proprietorship, partnership, or limited liability company filing a  
15 business profits tax return as a proprietorship, partnership, or limited liability company, a deduction  
16 equal to a fair and reasonable compensation for the personal services of a natural person who is a  
17 proprietor, partner, or member provided to the business organization, provided, however, that the  
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24 property, the sale of property and services, and other amounts due to services rendered.

25           (b) A taxpayer claiming a deduction under this paragraph shall bear the burden of  
26 proving that at least one or more proprietors, partners, or members provided actual services to the  
27 business organization at any time during the taxable period. Once a taxpayer has satisfied this  
28 burden of proof, the amount claimed as a deduction shall be presumed to be reasonable, unless the  
29 commissioner proves by a preponderance of the evidence that the deduction claimed by the taxpayer  
30 is grossly excessive.

31       3 Applicability. This act shall apply with respect to taxable periods ending after January 1,

**SB 125-FN-A - AS AMENDED BY THE SENATE**

**- Page 2 -**

1 2013.

2 4 Effective Date. This act shall take effect April 15, 2013.

LBAO  
11-0212  
12/20/10

**SB 125-FN-A - FISCAL NOTE**

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**FISCAL IMPACT:**

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**METHODOLOGY:**

The Department of Revenue Administration states this bill would transfer the burden of proof for the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships to the Department. The Department states this bill would make it responsible for proving whether a deduction taken for reasonable compensation is grossly excessive. The Department states this bill will make it difficult for it to dispute a taxpayer's compensation deduction because the Department does not have any information about the services rendered by the partnership or proprietorship. The Department states as a result, it would be ineffective to conduct an audit of a partnership or proprietorship to ensure compliance with the law.

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SB 125-FN-A - FINAL VERSION

03/23/11 1158s  
18May2011... 1717h

2011 SESSION

11-0212  
09/10

SENATE BILL **125-FN-A**

AN ACT relative to the standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

SPONSORS: Sen. Bradley, Dist 3; Sen. Barnes, Jr., Dist 17; Sen. Boutin, Dist 16; Sen. Bragdon, Dist 11; Sen. Carson, Dist 14; Sen. De Blois, Dist 18; Sen. Forrester, Dist 2; Sen. Forsythe, Dist 4; Sen. Gallus, Dist 1; Sen. Lambert, Dist 13; Sen. Luther, Dist 12; Sen. Morse, Dist 22; Sen. Rausch, Dist 19; Sen. Sanborn, Dist 7; Sen. Stiles, Dist 24; Sen. White, Dist 9; Rep. Chandler, Carr 1; Rep. Hess, Merr 9; Rep. Major, Rock 8; Rep. Tucker, Rock 17; Rep. Bettencourt, Rock 4

COMMITTEE: Ways and Means

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STATE OF NEW HAMPSHIRE

*In the Year of Our Lord Two Thousand Eleven*

AN ACT                   relative to the standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

*Be it Enacted by the Senate and House of Representatives in General Court convened:*

1           1 Purpose. The legislature finds that:

2           I. Small businesses are the lifeblood of the New Hampshire economy and are the most  
3 important source of jobs for residents of New Hampshire.

4           II. Recent increases in audits of small businesses in which small business owners are not  
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9 compliance, and enhance the competitiveness of our economy.

10           IV. This act clarifies important business profits tax rules that apply to small businesses,  
11 eliminates costly and inefficient audits, and restores New Hampshire's ability to encourage small  
12 business growth and the good jobs these businesses create.

13           2 Clarification of Reasonable Compensation Deduction. RSA 77-A:4, III is repealed and  
14 reenacted as follows:

15           III.(a) In the case of a proprietorship, partnership, or limited liability company filing a  
16 business profits tax return as a proprietorship or partnership, a deduction equal to a fair and  
17 reasonable compensation for the actual personal services of a natural person who is a proprietor,  
18 partner, or member provided to the business organization; provided, however, that the amount of  
19 such deduction shall not reduce such business organization's taxable business profits to less than  
20 zero. The purpose of this paragraph is to permit a deduction from gross business profits of such a  
21 proprietorship, partnership, or limited liability company of all amounts that are fairly attributable to  
22 the actual personal services of the proprietor, partner, or member. Such amounts shall not exceed  
23 the amount reported as earned income on the federal income tax returns of the proprietor, partner,  
24 or member, but may also include an amount not to exceed net rental income as compensation for  
25 operating rental property, and an amount not to exceed 15 percent of the gross selling price as  
26 commissions on the sale of business assets.

27           (b) Subject to the provisions of subparagraph (c) which establishes a record-keeping safe  
28 harbor, the method of determining the amount of the deduction available to the business

1 organization allowed under this paragraph shall be by using the standards set forth in section  
2 162(a)(1) of the United States Internal Revenue Code, as it may be amended from time to time, and  
3 the Treasury Regulations, administrative rulings, and judicial cases issued thereunder. The  
4 business organization shall keep such records as may be necessary to determine that the deduction  
5 is reasonable under these standards.

6 (c) In lieu of substantiating the value of the personal services of proprietors, partners, or  
7 members, a business organization or group of related business organizations may elect, as a record-  
8 keeping safe harbor, to deduct up to \$50,000 as total compensation for the tax year;

9 (d)(1) In this paragraph, "record-keeping safe harbor" means that amount of  
10 compensation for personal services claimed by a business organization which does not need to be  
11 substantiated by any evidence, records, or legal or regulatory authority, except as provided in  
12 subparagraph (e).

13 (2) Notwithstanding subparagraph III(d)(1), the record-keeping safe harbor shall not  
14 be relevant or admissible for any purpose in determining whether a compensation deduction claimed  
15 in an amount in excess of any such record-keeping safe harbor is fair and reasonable.

16 (e) A business organization or group of related business organizations may elect the  
17 record-keeping safe harbor option in subparagraph III(c) without a redetermination of the  
18 reasonableness of the deduction by the commissioner. Any such deduction claimed by the business  
19 organization or group of related business organizations shall not be subject to challenge; provided,  
20 that upon request, the business organization or group of related business organizations shall be  
21 required to substantiate that the proprietor or at least one partner or member performed actual  
22 personal services for the business organization or group of related business organizations.

23 (f) Related business organizations electing not to substantiate the extent of the actual  
24 personal services of their proprietors, partners, and members, shall be limited to the record-keeping  
25 safe harbor deduction, less any owners' compensation taken on the federal tax returns of corporate  
26 members of the group, allocated among the related business organizations. For the purposes of  
27 RSA 77-A:4, III, "related business organizations" are unitary business organizations and business  
28 organizations that would qualify as unitary but for the fact that they conduct business only within  
29 the state.

30 (g) A business organization claiming a deduction under this paragraph shall bear the  
31 burden of proving that all proprietors, partners, or members for whom a deduction is being claimed  
32 provided actual personal services to the business organization at any time during the taxable period.  
33 Once a business organization has satisfied this burden of proof, the amount claimed as a deduction  
34 shall be presumed to be reasonable, unless the commissioner proves by a preponderance of the  
35 evidence that the deduction claimed by the business organization is clearly unreasonable.

36 3 New Paragraph; Appeal for Redetermination or Reconsideration; Procedure. Amend RSA 21-  
37 J:28-b by inserting after paragraph VII the following new paragraph:

1 VIII. The department shall bear the burden of proof on any change to any compensation  
2 deduction under RSA 77-A determined by examination.

3 4 New Section; Interest and Dividends Tax; Excess Compensation. Amend RSA 77 by inserting  
4 after section 4-f the following new section:

5 77:4-g Dividend. Excess compensation determined by audit of the department shall not be  
6 considered a dividend under this chapter unless such determination is accepted by the Internal  
7 Revenue Service.

8 5 Taxpayer Records. Amend RSA 77-A:11, I to read as follows:

9 I. Keep such records as may be necessary to determine the amount of its liability under this  
10 chapter *and to determine whether the compensation claimed as a deduction under RSA 77-*  
11 *A:4, III is reasonable;*

12 6 Applicability. This act shall apply with respect to taxable periods beginning on or after  
13 January 1, 2011.

14 7 Effective Date. This act shall take effect upon its passage.

LBAO  
11-0212  
Amended 05/23/11

## SB 125-FN - FISCAL NOTE

AN ACT relative to the standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

## FISCAL IMPACT:

The Department of Revenue Administration states this bill, as amended by the House (Amendment #2011-1717h), may decrease state revenue by an indeterminable amount in FY 2012 and each year thereafter. There will be no fiscal impact on county and local revenue, or state, county, and local expenditures.

## METHODOLOGY:

The Department of Revenue Administration states this bill would permit a proprietorship or partnership to claim a deduction from gross business profits of all amounts which are fairly attributable to the actual personal services of the proprietor, partner, or member. The method of determining the amount of the compensation deduction available to the business organization shall be by using the standards set forth in the Internal Revenue Code Section 162(a)(1) and the Treasury Regulations, administrative rulings and judicial cases issued thereunder. The bill requires the business organization to keep record as may be necessary to determine that the deduction is reasonable under Section 162(a)(1). The bill allows a business organization to elect a "record-keeping safe harbor" of up to \$50,000 as total compensation for the tax year. The bill also transfers the burden of proving the reasonableness of the claimed compensation deduction to the Department. The effective date of the proposed bill is upon passage, and the changes would be applicable for taxable periods beginning on or after January 1, 2011.

The Department states the proposed bill could potentially reduce state revenue in the range of \$0 to \$5,000,000 annually from reduced Business Profits Tax (BPT) revenue and/or decreased revenue received through audit activity. The estimated \$5,000,000 maximum loss of revenue is based on 2009 audit activity in which the Department audited business tax returns of Non-Water's Edge entities and wherein the compensation deduction may have been an issue of audit.

# Committee Minutes

**SENATE CALENDAR NOTICE  
WAYS AND MEANS**

Senator Bob Odell Chairman  
 Senator Jim Luther V Chairman  
 Senator David Boutin  
 Senator Lou D'Allesandro  
 Senator Chuck Morse  
 Senator Jim Rausch

For Use by Senate Clerk's Office ONLY	
<input type="checkbox"/>	Bill Status
<input type="checkbox"/>	Docket
<input type="checkbox"/>	Calendar
Proof: <input type="checkbox"/>	Calendar <input type="checkbox"/> Bill Status

**Date: February 23, 2011**

**HEARINGS**

**Monday**

**3/7/2011**

<b>WAYS AND MEANS</b>	<b>SH 100</b>	<b>11:00 AM</b>
(Name of Committee)	(Place)	(Time)

**EXECUTIVE SESSION MAY FOLLOW**

**Comments:** \*\*The Committee will break from 12:00 - 1:00 PM

- |          |              |   |
|----------|--------------|---|
| 11:00 AM | SB182-FN-A-L | relative to video lottery and table gaming, providing property tax relief for local economies, providing services for problem gamers, and promoting tourism and public safety.                                      |
| 11:30 AM | SB125-FN-A   | relative to the business profits tax deduction for reasonable compensation.   |
| 1:00 PM  | SB56-FN      | authorizing the department of revenue administration to accept credit card payments of taxes.   |
| 1:15 PM  | SB79-FN      | authorizing the department of revenue administration to impose administrative fines for timber tax violations.  |
| 1:30 PM  | SB132-FN-A-L | establishing exemptions from the real estate transfer tax.  |
| 1:45 PM  | SB155-FN-A   | relative to section 179 expense deductions under the business profits tax.  |
| 2:00 PM  | SB167-FN-A-L | establishing a production jobs creation credit under the business enterprise tax and making changes affecting small business to the business profits tax, the business enterprise tax, and the meals and rooms tax. |

**Sponsors:**

Sonja Caldwell 271-2117

Sen. Bob Odell  
Chairman

**SENATE CALENDAR NOTICE  
WAYS AND MEANS**

Senator Bob Odell Chairman  
 Senator Jim Luther V Chairman  
 Senator David Boutin  
 Senator Lou D'Allesandro  
 Senator Chuck Morse  
 Senator Jim Rausch

For Use by Senate Clerk's Office ONLY	
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**Date: February 23, 2011**

**HEARINGS**

**Monday**

**3/7/2011**

WAYS AND MEANS

SH 100

11:00 AM

(Name of Committee)

(Place)

(Time)

**EXECUTIVE SESSION MAY FOLLOW**

**Comments:** \*\*The Committee will break from 12:00 - 1:00 PM

**SB182-FN-A-L**

Sen. Lou D'Allesandro

Sen. Jim Rausch

Sen. John Gallus

**SB125-FN-A**

Sen. Jeb Bradley

Sen. John Barnes, Jr.

Sen. David Boutin

Sen. Peter Bragdon

Sen. Sharon Carson

Sen. Tom De Blois

Sen. Jeanie Forrester

Sen. James Forsythe

Sen. John Gallus

Sen. Gary Lambert

Sen. Jim Luther

Sen. Chuck Morse

Sen. Jim Rausch

Sen. Andy Sanborn

Sen. Nancy Stiles

Sen. Raymond White

Rep. Gene Chandler

Rep. David Hess

Rep. Norman Major

Rep. Pamela Tucker

Rep. David Bettencourt

**SB56-FN**

Sen. Bob Odell

**SB79-FN**

Sen. Bob Odell

**SB132-FN-A-L**

Sen. Andy Sanborn

Sen. Peter Bragdon

Sen. James Forsythe

Sen. Raymond White

Sen. Jeb Bradley

Sen. Jim Rausch

Sen. Fenton Groen

Sen. Tom De Blois

Sen. Jeanie Forrester

Rep. Norman Major

Rep. Thomas Keane

Rep. Dan McGuire

Rep. David Bettencourt

Rep. Jennifer Coffey

**SB155-FN-A**

Sen. Jeanie Forrester

Sen. John Gallus

Sen. James Forsythe

Sen. Andy Sanborn

Rep. Colette Worsman

Rep. Gene Chandler

**SB167-FN-A-L**

Sen. Jeb Bradley

Sen. John Barnes, Jr.

Sen. David Boutin

Sen. Sharon Carson

Sen. Tom De Blois

Sen. James Forsythe

Sen. John Gallus

Sen. Gary Lambert

Sen. Jim Luther

Sen. Jim Rausch

Sen. Nancy Stiles

Sen. Raymond White

Rep. Gene Chandler

Rep. William O'Brien

Rep. David Bettencourt

Sonja Caldwell 271-2117

Sen. Bob Odell

Chairman



# Ways and Means Committee

## Hearing Report

**To:** Members of the Senate

**From:** Sonja Caldwell  
*Legislative Aide*

**Re:** **SB125-FN-A** – *relative to the business profits tax deduction for reasonable compensation.*

**Hearing date:** March 7, 2011

**Members present:** Sen. Odell, Sen. Luther, Sen. Boutin, Sen. D'Allesandro, Sen. Morse, Sen. Rausch

**Members absent:**

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**Sponsor(s):** Sen. Bradley, Dist 3; Sen. Barnes, Jr., Dist 17; Sen. Boutin, Dist 16; Sen. Bragdon, Dist 11; Sen. Carson, Dist 14; Sen. De Blois, Dist 18; Sen. Forrester, Dist 2; Sen. Forsythe, Dist 4; Sen. Gallus, Dist 1; Sen. Lambert, Dist 13; Sen. Luther, Dist 12; Sen. Morse, Dist 22; Sen. Rausch, Dist 19; Sen. Sanborn, Dist 7; Sen. Stiles, Dist 24; Sen. White, Dist 9; Rep. Chandler, Carr 1; Rep. Hess, Merr 9; Rep. Major, Rock 8; Rep. Tucker, Rock 17; Rep. Bettencourt, Rock 4

**What the bill does:** This bill modifies standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

**Who supports the bill:** Sen. Sharon Carson, Sen. Jim Rausch, Sen. Jeannie Forrester, Sen. Tom De Blois, Sen. Nancy Stiles, Rep. Norman Major, Sen. John Gallus, Sen. Chuck Morse, Sen. David Boutin, Sen. Ray White, Sen. Peter Bragdon, Sen. Jeb Bradley, Sen. James Forsythe, Sen. Andy Sanborn, Sen. James Luther, Henry Veilleux (NH Lodging & Restaurant Assoc.), Lyman Pope Jr. (Jackson, NH), Dave Juvet (BIA), Jason Stock (NH Timberland Owners Assoc.) G. Philip Blatsos (Self)

**Who opposes the bill:**

**Taking no position:** Rep. Hess

### **Summary of testimony received:**

**Senator Bradley** said he is back here with the same bill as last year. It was SB476 last year. This bill shifts the burden of proof to the Department of Revenue Administration to prove someone is unreasonably compensating themselves. Many tried to bring more rationality to this process last year but this is still a huge problem. He said he knows the problem we face with the budget deficit, but the DRA is using the opportunity they have with the burden being on the businesses as an income tax on business owners. He added that most jobs get created by small business owners and this is the wrong approach for our state to take. He said we should not use the BPT to receive more revenue than state is entitled to. This provision has created a climate of uncertainty for business owners. If someone does not know what the ruling of DRA will be in terms of what income is or is not subject to the BPT, its not helpful for NH in terms of attracting new business. He said he has taken phone calls from people who have gone through the audit process. It is an extreme process and a lot of documentation is required. Auditors visit businesses for weeks and scrounge through paperwork. Some have brought in experts to justify their compensation. He's been told that experts have been ignored. He said there is little nexus for decisions that are made on what is reasonable and what isn't. Audits have become fishing expeditions. He said fear of high costs for business owners, tax preparers, and lawyers is forcing people to just write the check to the state. He believes this should be one of our top tax priorities. He added that it would be useful for the committee to talk to people who have gone through the audit process but they are afraid to testify. He said that with regard to the fiscal note, the same bill last year had a fiscal note that said this will result in an indeterminable decrease in BPT revenue, however, a year later, the fiscal note says it will result in a \$49 million decrease in revenue. He said the disparity in the two fiscal notes is striking and he hopes the DRA can justify their claims.

**Senator Boutin** said he was astounded by this fiscal note compared to last year's. He asked Senator Bradley if he had the chance to talk to DRA to understand the difference.

**Senator Bradley** said he wrote them a letter and asked for their worksheets.

**Senator Boutin** commented that DRA said they could have a sense, based on national data, what reasonable compensation is but now they say they cant do it and that is another discrepancy.

**Senator Luther** asked how NH compares to other states.

**Senator Bradley** said that was a good question but he doesn't know the answer except that our BPT is among the highest in nation but we don't have an income tax.

**Senator Rausch** said when this tax was first instituted, you could claim reasonable compensation and it was accepted by the DRA. It seems to have evolved now to where the DRA determines it.

**Senator Bradley** said the old rule was that the burden was on the DRA. When this change was made, it was designed to be revenue neutral some 20 years ago. The department is determining what level is reasonable compensation.

**Senator Luther** asked if he has a sense as to how this impacts the business climate in NH.

**Senator Bradley** answered that business owners talk to each other and as more audits are conducted, they realize NH is going after small businesses. It is having a significant impact on one's perception of NH.

**Phil Blatsos** said he has spoken against changes to the compensation deduction in the past. He said he is representing himself. He said SB125 and HB611 are the same. This is walking us back to the way we were with the burden on the state versus the individual. The fiscal note on HB611 says indeterminable. He said the change in 1991 was de minimis. Last year it was supposed to be revenue neutral. He said that going back to the way it was should have no impact. There is some risk for loss but its not very high. The formation of new business drives the economy. There is a propensity to underpay not overpay. He estimated the cost of fighting an audit at \$35,000. He is concerned that no one is going to feel like they were fairly treated. He thinks this change should be added under the audit provision.

**Dave Juvet** of the BIA testified in support. He said there is a desirability for a safe harbor for the state's smallest businesses. They would like to see \$50,000 per individual as opposed to per entity. He added that most would prefer to see \$100,000.

**Senator Odell** asked if he was suggesting we need to put that into this bill. **Mr. Juvet** said when he spoke to the sponsors, it was their feeling that this bill would dispense with the need for a safe harbor but accountants they talked to still thought there was a need for record keeping purposes.

#### **Mindy Cyr and Kathleen Sher of the DRA**

They said the reason that this year's fiscal note shows a \$49 million loss when last year it was indeterminable is because last year they didn't have the information obtainable to make that determination. The department started pulling returns and getting identifiable information from actual returns. They were able to identify a compensation amount which came out to \$49 million. They used the returns they pulled form 2008 to get the information.

Ms. Sher said \$49 million is the maximum they see that we would lose. It

could be anything up to that amount.

**Senator Odell** said the closer you get to that maximum is a presumption that all tax payers in this category move in the same direction.

**Ms. Sher** said the problem with the way the bill is constructed is that you allow deduction for reasonable compensation but you don't allow the department to challenge anything beyond what is grossly excessive rather than reasonable. She doesn't know how the department would administer something like that from an audit perspective. In the reasonable category they have federal guidance, however, from an audit standpoint the standard is grossly excessive.

**Senator Odell** said the committee heard testimony categorizing audits. He asked how she would describe the audit process.

**Ms. Sher** said she has been Audit Director since June and has been with the department for 10 years. The first cases she saw back in 1999 were reasonable compensation cases. She said this is not a new issue. There was more audit activity in 2004 when programs were stepped up and she said that may have highlighted the extent of the issue. She said in 2004 there was a change in the way the department was asked to reflect its activities in the annual report. Each touch of a taxpayer document was considered an audit. The fact that it was looked at by a human made it an audit for the purpose of the annual reports.

**Senator D'Allesandro** said that in the fiscal note, the department clearly states that revenues will decrease by \$49 million, but now they say its between 0 and \$49 million. If it's a range that's different than what is stated in the fiscal note. He also pointed out that in the methodology it says it will be difficult for the department to dispute a taxpayer's compensation because they don't have any information about the services rendered by the partnership or proprietorship. He asked how they can you say they don't have any information when they file a return.

They responded that all they have is the number they have chosen for their reasonable compensation and along with that there are other deductions they might take. If it's identified as an issue by the department, they have to ask what they do. They don't know any of that information from the tax return.

**Senator D'Allesandro** asked how they are determining reasonable compensation on this years returns.

They said they haven't done it yet. They are still under the old standard.

# Speakers





# Testimony



**STATE OF NEW HAMPSHIRE  
OFFICE OF LEGISLATIVE BUDGET ASSISTANT  
FISCAL NOTE WORKSHEET**

Date Sent to Agency: 01/21/2011

LSR #: 11-1050.1

Agency: Department of Revenue Administration

Bill #: SB125

Due to LBAO: 02/04/2011

Amendment #(s): \_\_\_\_\_

Correction to a prior response? (Y/N): No

State Fund(s) Affected:

**(1) Indicate here what state funds will be affected by the bill: general funds, federal funds, or any special fund. If it is a special fund, please specify.**

General: XXX Federal: \_\_\_\_\_ Other: Education Trust Fund

	FIRST BIENNIUM			SECOND BIENNIUM	
	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
State Revenue	Not Applicable	See Section C	See Section C	See Section C	See Section C
State Expenditure					
Net State Impact	Not Applicable	See Section C	See Section C	See Section C	See Section C
County Revenue	Not Applicable				
County Expenditure					
Net County Impact	Not Applicable				
Local Revenue	Not Applicable				
Local Expenditure					
Net Local Impact	Not Applicable				

- NOTE: (1) List only the amount of change in the appropriate column.  
 (2) Place all negative numbers in parenthesis.  
 (3) You may replicate this worksheet.  
 (4) Refer to Guidelines for Fiscal Note Worksheets for further information.

- (A) **ASSUMPTIONS:** Explain how estimate was derived. Describe costs that can be absorbed without additional funding. If no estimate can be prepared, explain why in detail. If no fiscal impact, explain why in detail.

This law has 8 different sections proposing changes and each section will be addressed individually.

**Section 2 Business Enterprise Tax, Production Jobs Creation Tax Credit**

1. This law could be administered by the Department of Revenue Administration with additional costs to audit and verify the validity of the complex credit. Also additional costs would be incurred to draft rules, revise computer systems and create the necessary forms in order to be able to implement this credit.
2. It seems that proposed RSA 77-E:3-d, II, (e) (4) requiring that "qualified production compensation" be capitalized under Section 263A of the United States Internal Revenue Code would restrict who could be eligible for this credit to only large business organizations. Section 263A applies to taxpayers with average annual gross receipts of \$10 million for the three preceding tax years.
3. Even though the credit is limited to \$50,000 per year per taxpayer, the Department cannot estimate the loss of Business Enterprise Tax revenue from this provision as we do not have any data about taxpayers who are required to capitalize qualified production compensation or the dollar value of said compensation. Therefore it is impossible to predict the cost of this credit. As there does not appear to be any restriction against it, taxpayers could avail themselves of this credit and be eligible for the Economic Revitalization Zone Tax Credit as well based upon the same wages and employees.

**Section 3 Business Profits Tax, Increased Filing Threshold**

4. This law seeks to increase the filing threshold under the Business Profits Tax from in excess of \$50,000 to in excess of \$75,000.
5. The amount of the gross receipts of each taxpayer is not captured on any New Hampshire tax form and a coupling of NH taxpayers with their respective federal tax information would be extremely time consuming with the computer systems currently in place and the results would be far less than 100% matches due to the disparity in federal and NH filing practices.
6. An estimate of the possible loss of revenue based upon the increased filing threshold cannot be made but it should not be a significant amount of BPT nor BET revenue.

**Section 4 Business Enterprise Tax, Increased Filing Threshold**

7. This law seeks to increase the filing thresholds under the Business Enterprise Tax from in excess of \$150,000 to in excess of **\$175,000** gross business receipts and increasing the enterprise value tax base of which is greater than \$75,000 to **\$125,000**.
8. The amount of the gross receipts of each taxpayer is not captured on any New Hampshire tax form and a coupling of NH taxpayers with their respective federal tax information would be extremely time consuming with the computer systems currently in place and the results would be far less than 100% matches due to the disparity in federal and NH filing practices.

9. A maximum estimate of the possible loss of BET revenue is based upon those taxpayers who filed Business tax returns in FY10 and whose BETVB was less than \$125,000. They paid BET of \$8,851,525. While it is not known how many of those taxpayers had gross receipts of more than \$175,000 so that they would still have to pay the tax, it seems that the maximum loss of BET revenues would be \$8,851,525.

#### **Section 5 Business Enterprise Tax, Elimination of Taxation of Floor Plan Costs**

10. This law would classify interest which would not be taxable under BET to include, "Amounts paid, credited, or set aside by a person who regularly sells or otherwise disposes of tangible personal inventory property pursuant to floor plan arrangements that provide for advances or payments directly in connection with the acquisition or disposition of such inventory property."
11. An estimate of the possible loss of revenue cannot be made as the Department does not have any data upon which to make an estimate.

#### **Section 6 Meals and Rooms Tax, Temporary Assistance for Certain Operators**

12. This law would allow operators to take a 5% commission of the taxes collected instead of a 3% commission of the taxes collected if their prior calendar had less than \$200,000 in taxable gross receipts. It would appear that this disparate treatment of operators may be **unconstitutional**. See Section E, Technical or Mechanical Defects. The operators collect the tax on behalf of the state. The taxes are not paid by them nor are they for their personal use. In essence the Legislature would be giving the operators more commission for collecting less tax.
13. Assuming that this law is constitutional, the Department used data from all taxable periods ending in calendar year 2010 for this analysis. We will assume that the data will be relatively the same for calendar year 2011 so that we may estimate a projected loss of M&R revenues.

#### **Section 7 Business Profits Tax, Deduction**

14. This law would allow parent organizations to take a deduction equal to the "deductible amount" of gross business profits derived from distributions from another organization if certain conditions are met. It would seem that this law would be in conflict with the Commerce Clause of the United States Constitution and would overturn the New Hampshire Supreme Court case of General Electric Co. V Commissioner, 154 NH 457, 914 A2d 246 (2006). It would appear that this disparate treatment of taxpayers, in-state versus out of state, may be **unconstitutional**. See Section E, Technical or Mechanical Defects.
15. Amendments to the apportionment methodologies under the BPT law have rendered these provisions obsolete. The harm they are intended to protect against, the threat of double taxation in certain specific circumstances, is addressed through federal constitutional law, state case law and the appropriate application of RSA 77-A, through inter-company eliminations and separate entity adjustments.
16. A fiscal analysis of the large negative consequences of this law cannot be estimated.

#### **Section 8 Business Profits Tax, Addition to Gross Business Profits**

17. This law would allow business organizations to make an addition to gross business profits of depreciation or amortization attributable to any such increase in the basis of its assets BUT shall determine gain or loss without taking into account the increase in basis.
18. It is assumed that millions of dollars would have to be refunded based upon the retroactive application of this law as it would become effective for taxable periods that began on or after **January 1, 2005**.

**Section 9** Business Profits Tax, Definition of Business Organization

19. This law would change the definition of "business organization" for BPT purposes and it is assumed that it could lead to the demise of the Business Profits Tax.
20. NH taxes business organizations as separate entities in order to treat all business organizations on an equitable basis. Should this law pass NH would no longer be able to provide equitable treatment and thus the BPT would be susceptible to challenges to its constitutionality.
21. A fiscal analysis of the large negative consequences of this law cannot be estimated but the worse case scenario could be the loss of all FY12 BPT revenues. Estimated BPT revenues for FY11 are \$313 million.

(B) **METHOD:** Show calculations used to determine fiscal impact. **Calculations must agree with and explain totals on first page.**

**Section 2** Business Enterprise Tax, Production Jobs Creation Tax Credit  
Cannot Be Determined

**Section 3** Business Profits Tax, Increased Filing Threshold  
Cannot Be Determined

**Section 4** Business Enterprise Tax, Increased Filing Threshold  
Maximum loss of **\$8,851,525** paid by taxpayers whose BETVB was less than \$125,000.

**Section 5** Business Enterprise Tax, Elimination of Taxation of Floor Plan Costs  
Cannot Be Determined

**Section 6** Meals and Rooms Tax, Temporary Assistance for Certain Operators  
Out of 7,742 licensed operators in calendar year 2010, 5,448 of them had less than \$200,000 in taxable M&R gross receipts. They collected \$20,293,796 in M&R taxes and could have taken \$608,814 in commissions at 3%. Commissions of 5% on \$20,293,796 would be \$1,014,690. Thus this new allowance would cause a loss of M&R revenue in the amount of \$405,876 per year.

**Section 7** Business Profits Tax, Deduction  
Cannot Be Determined

**Section 8** Business Profits Tax, Addition to Gross Business Profits  
in excess of \$5 million in possible refunds in addition to lost future revenues.

**Section 9** Business Profits Tax, Definition of Business Organization  
Cannot Be Determined

(C) **ESTIMATED FISCAL IMPACT (from A and B): Estimated Fiscal Impact must agree with the totals on first page.**

**Section 2** Business Enterprise Tax, Production Jobs Creation Tax Credit  
Cannot Be Determined

**Section 3** Business Profits Tax, Increased Filing Threshold  
Cannot Be Determined

**Section 4** Business Enterprise Tax, Increased Filing Threshold  
Maximum loss of revenue of \$8,851,525 paid by taxpayers whose BETVB was less than \$125,000.

**Section 5** Business Enterprise Tax, Elimination of Taxation of Floor Plan Costs  
Cannot Be Determined

**Section 6** Meals and Rooms Tax, Temporary Assistance for Certain Operators  
This new allowance would cause a loss of M\$R revenue in the amount of \$405,876 per year.

**Section 7** Business Profits Tax, Deduction  
Cannot Be Determined

**Section 8** Business Profits Tax, Addition to Gross Business Profits  
In excess of \$5 million in possible refunds in addition to lost future revenues.

**Section 9** Business Profits Tax, Definition of Business Organization  
Cannot Be Determined

(D) **ADDITIONAL COUNTY, LOCAL OR LONG-RANGE EFFECTS:**

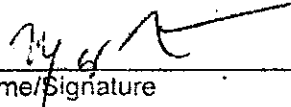
(E) **TECHNICAL OR MECHANICAL DEFECTS:** Note any conflicts with existing law. Do not comment on the merits of the legislation.

Constitutional Issues: "Distinctions in tax treatment must rest upon reasonable classifications of property, not upon classifications of taxpayers owning a common class of property." Opinion of Justices, 132 N.H. 777 (1990) citing Opinion of Justices, 115 N.H. 306 (1975).

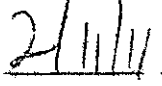
A review by a constitutional tax lawyer should be performed on Sections 6 and 7 of this bill.

(F) **OTHER COMMENTS:** Include tax variables, federal mandates, etc.

AGENCY REPRESENTATIVE PREPARING WORKSHEET: John C. Lighthall NHDRA 271-1321

  
Approval Name/Signature

Asst. Commissioner NHDRA 271-2318  
Title, Agency and Phone Number

  
Date

# Voting Sheets

2 audio files

11:34

121

# Senate Ways & Means Committee EXECUTIVE SESSION

Bill # SB 125

Hearing date: 3-7-11

Room: State House - Room 100

Executive session date: 3-7-11

Motion of: OTF

VOTE: 5-0

Made by Odell   
Senator: D'Allesandro   
 Luther   
 Boutin   
 Morse   
 Rausch

Seconded Odell   
by Senator: D'Allesandro   
 Luther   
 Boutin   
 Morse   
 Rausch

<u>Committee Member</u>	<u>Present</u>	<u>exc</u>	<u>YES</u>	<u>NO</u>	<u>Reported out by</u>
Senator Odell	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Senator D'Allesandro	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>	
Senator Luther	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Senator Boutin	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Senator Morse	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Morse
Senator Rausch	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	

\*Amendments: 0679 withdrawn by Boutin

NOTES: Fiscal note is 0-49m, to get to 49 you would have to have 100% of ppl changing their behavior

Boutin amend - language from Blattsos

Independent Investor test is something they use & amend wouldn't let them applicability - all current open audits



# Committee Report

STATE OF NEW HAMPSHIRE  
SENATE  
REPORT OF THE COMMITTEE

Date: March 8, 2011

THE COMMITTEE ON Ways and Means

to which was referred Senate Bill 125-FN-A

AN ACT                      relative to the business profits tax deduction for  
reasonable compensation.

Having considered the same, the committee recommends that the Bill:

**OUGHT TO PASS**

BY A VOTE OF:    5-0

AMENDMENT #        s

Senator Chuck Morse  
For the Committee

Sonja Caldwell 271-2117

## New Hampshire General Court - Bill Status System

**Docket of SB125**

Docket Abbreviations

**Bill Title:** (New Title) relative to the standards and burden of proof with respect to the business profits tax deduction for reasonable compensation attributable to owners of partnerships, limited liability companies, and sole proprietorships.

*Official Docket of SB125:*

<b>Date</b>	<b>Body</b>	<b>Description</b>
1/19/2011	S	Introduced and Referred to Ways & Means, <b>SJ 3</b> , Pg.37
2/24/2011	S	Hearing: 3/7/11, Room 100, State House, 11:30 a.m.; <b>SC13</b>
3/8/2011	S	Committee Report: Ought to Pass, 3/16/11; <b>SC15</b>
3/16/2011	S	Ought to Pass, MA, VV; Refer to Finance Rule 4-3
3/17/2011	S	Committee Report: Ought to Pass, 3/23/2011; <b>SC16</b>
3/23/2011	S	Sen. Morse Floor Amendment #2011-1158s, AA, VV; <b>SJ 10</b> , Pg.175
3/23/2011	S	Ought to Pass with Amendment 1158s, <b>RC 24Y-0N</b> , MA; OT3rdg; <b>SJ 10</b> , Pg.175
3/23/2011	S	Passed by Third Reading Resolution; <b>SJ 10</b> , Pg.187
3/28/2011	H	Introduced and Referred to Ways and Means [3/17/2011]; <b>HJ 30</b> , PG.1037
3/30/2011	H	Public Hearing: 4/5/2011 10:45 AM LOB 202
4/13/2011	H	==CANCELLED== Executive Session: 4/26/2011 10:00 AM LOB 202
4/26/2011	H	Subcommittee Work Session: 4/28/2011 1:30 PM LOB 202
4/29/2011	H	Subcommittee Work Session: 5/2/2011 2:00 PM LOB 202
5/3/2011	H	Executive Session: 5/10/2011 11:00 AM LOB 202
5/10/2011	H	Majority Committee Report: Ought to Pass with Amendment #1717h(NT) for May 18 (Vote 16-5; RC); <b>HC 39</b> , PG.1326
5/10/2011	H	Proposed Majority Committee Amendment #2011-1717h (New Title); <b>HC 39</b> , PG.1348-1349
5/10/2011	H	Minority Committee Report: Inexpedient to Legislate; <b>HC 39</b> , PG.1326
5/18/2011	H	Amendment #1717h (New Title) Adopted, VV; <b>HJ 44</b> , PG.1555-1557
5/18/2011	H	Ought to Pass with Amendment #1717h(NT): MA <b>RC 340-9</b> ; <b>HJ 44</b> , PG.1555-1559
6/1/2011	S	Sen. Odell Concurs with House Amendment #1717h, NT, MA, VV; <b>SJ 19</b>
6/8/2011	H	Enrolled
6/8/2011	S	Enrolled

NH House

NH Senate

# Other Referrals

# COMMITTEE REPORT FILE INVENTORY

SB125 ORIGINAL REFERRAL \_\_\_\_\_ RE-REFERRAL

1. THIS INVENTORY IS TO BE SIGNED AND DATED BY THE COMMITTEE AIDE AND PLACED INSIDE THE FOLDER AS THE FIRST ITEM IN THE COMMITTEE FILE.
2. PLACE ALL DOCUMENTS IN THE FOLDER FOLLOWING THE INVENTORY IN THE ORDER LISTED.
3. THE DOCUMENTS WHICH HAVE AN "X" BESIDE THEM ARE CONFIRMED AS BEING IN THE FOLDER.
4. THE COMPLETED FILE IS THEN DELIVERED TO THE CALENDAR CLERK.

DOCKET (Submit only the latest docket found in Bill Status)

COMMITTEE REPORT

CALENDAR NOTICE

HEARING REPORT

\_\_\_\_\_ HANDOUTS FROM THE PUBLIC HEARING

\_\_\_\_\_ PREPARED TESTIMONY AND OTHER SUBMISSIONS

SIGN-UP SHEET(S)

ALL AMENDMENTS (passed or not) CONSIDERED BY COMMITTEE:

\_\_\_\_\_ - AMENDMENT # \_\_\_\_\_      \_\_\_\_\_ - AMENDMENT # \_\_\_\_\_  
\_\_\_\_\_ - AMENDMENT # \_\_\_\_\_      \_\_\_\_\_ - AMENDMENT # \_\_\_\_\_

ALL AVAILABLE VERSIONS OF THE BILL:

AS INTRODUCED      \_\_\_\_\_ AS AMENDED BY THE HOUSE  
 FINAL VERSION      \_\_\_\_\_ AS AMENDED BY THE SENATE

OTHER (Anything else deemed important but not listed above, such as amended fiscal notes): Fiscal note worksheet

IF YOU HAVE A RE-REFERRED BILL, YOU ARE GOING TO MAKE UP A DUPLICATE FILE FOLDER

DATE DELIVERED TO SENATE CLERK 7-22-11 SLC  
BY COMMITTEE AIDE