

# Bill as Introduced

HB 611-FN-A - AS INTRODUCED

2011 SESSION

11-0221  
09/10

HOUSE BILL            **611-FN-A**

AN ACT            relative to determination of the reasonable compensation deduction under the business profits tax.

SPONSORS:        Rep. Hess, Merr 9; Rep. Chandler, Carr 1; Rep. Bettencourt, Rock 4; Rep. Stepanek, Hills 6; Rep. Kurk, Hills 7; Sen. Bradley, Dist 3; Sen. Rausch, Dist 19; Sen. Sanborn, Dist 7

COMMITTEE:      Ways and Means

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ANALYSIS

This bill establishes standards and burden of proof for determination of the reasonable compensation deduction under the business profits tax.

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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Matter which is either (a) all new or (b) repealed and reenacted appears in regular type.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 determination of the reasonable compensation deduction under the business profits tax.

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

1           1 Determination of Reasonable Compensation Deduction. RSA 77-A:4, III is repealed and  
2 reenacted as follows:

3           III.(a) In the case of a proprietorship, partnership, or limited liability company filing a  
4 business profits tax return as a proprietorship or a partnership, a deduction equal to a fair and  
5 reasonable compensation for the personal services of a natural person who is a proprietor, partner, or  
6 member provided to the business organization, provided, however, that the amount of such deduction  
7 shall not exceed such business organization's gross business profits. The purpose of this paragraph  
8 is to permit a deduction from gross business profits of such a proprietorship, partnership, or limited  
9 liability company of all amounts that are fairly attributable to the personal services of the proprietor,  
10 partner, or member. Such amounts shall generally include all amounts reported as earned income  
11 on federal tax returns, but shall also include amounts attributable to personal services provided in  
12 connection with the operation and rental of real property, the sale of property and services, and other  
13 amounts due to services rendered.

14           (b) A taxpayer claiming a deduction under this paragraph shall bear the burden of  
15 proving that at least one or more proprietors, partners, or members provided actual services to the  
16 business organization at any time during the taxable period. Once a taxpayer has satisfied this  
17 burden of proof, the amount claimed as a deduction shall be presumed to be reasonable, unless the  
18 commissioner proves by clear and convincing evidence that the deduction claimed by the taxpayer is  
19 grossly excessive.

20           2 Applicability. Section 1 of this act shall apply with respect to taxable periods ending on or  
21 after June 30, 2011.

22           3 Effective Date. This act shall take effect June 30, 2011.

LBAO  
11-0221  
01/21/11

**HB 611-FN-A - FISCAL NOTE**

AN ACT relative to determination of the reasonable compensation deduction under the business profits tax.

**FISCAL IMPACT:**

The Department of Revenue Administration states this bill will decrease state revenues by an indeterminable amount in FY 2012 and each year thereafter. There will be no fiscal impact on county and local revenues, or state, county, and local expenditures.

**METHODOLOGY:**

This bill establishes standards and burden of proof for determination of the reasonable compensation deduction under the business profits tax attributable to owners of partnerships, limited liability companies, and sole proprietorships. The Department of Revenue Administration states the proposed legislation places the burden of proving the compensation deduction claimed on tax returns is grossly excessive onto the Department as opposed to having the taxpayer prove the validity of the deduction. The Department states this will result in an indeterminable decrease in BPT revenue which is deposited into the general fund and the education trust fund. Although the Department is unable to anticipate to what extent the proposed legislation will reduce BPT revenues, the language of the proposed legislation would only require the taxpayer to prove that one proprietor, partner or member provided actual services to the business. The Department notes this could potentially provide a means for partnerships, limited liability companies, and sole proprietorships to reduce their BPT liability to zero barring the Department's ability to prove that their deduction is grossly excessive. The Department notes that in tax year 2008, \$49,430,000 of BPT revenue was attributable to partnerships and proprietorships.

# Amendments

Amendment to HB 611-FN-A

1 Amend the bill by replacing section 1 with the following:

2

3 1 Determination of Reasonable Compensation Deduction. RSA 77-A:4, III is repealed and  
4 reenacted as follows:

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

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

# Committee Minutes

**HOUSE COMMITTEE ON WAYS AND MEANS**

**BILL NUMBER:** HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable  
compensation deduction under the business profits  
tax.

**DATE:** March 9, 2011

**THE COMMITTEE HAS VOTED TO RETAIN THIS BILL.**

A handwritten signature in black ink, appearing to read 'Stephen Stepanek', is written over a horizontal line. The signature is stylized and somewhat cursive.

**Stephen Stepanek, Chairman**



# Speakers



# Hearing Minutes

HOUSE COMMITTEE ON WAYS AND MEANS

PUBLIC HEARING ON HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** March 9, 2011

**LOB ROOM:** 202      **Time Public Hearing Called to Order:** 10:03 AM

**Time Adjourned:** 11:26 AM

(please circle if present)

**Committee Members:** Reps. Stepanek, Major, Griffin, Hess, Sapareto, Uler, Osgood, Ober, Abrami, Azarian, Daugherty, McDonnell, Murphy, Ohm, Sanborn, Shuler, Almy, Hamm, Butynski, Hatch and Cooney.

**Bill Sponsors:** Reps. Hess, Merr 9; Chandler, Carr 1; Bettencourt, Rock 4; Stepanek, Hills 6; Kurk, Hills 7; Sens. Bradley, Dist 3; Rausch, Dist 19; Sanborn, Dist 7

TESTIMONY

\* Use asterisk if written testimony and/or amendments are submitted.

**Representative Sapareto – supports.** Introduced the bill and noted the amendment. A discussion of the bill was held and what reasonable compensation consists of. This bill is the same as SB 25.

Comments about the burden of proof on taxpayers vs. DRA.

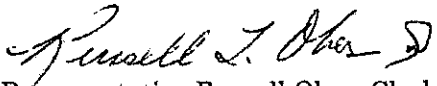
**John Lighthall & Margaret Fulton, DRA -** Question about the amount of evidence that must be shown by the DRA. LLC's are not a filter of taxes in the state of New Hampshire.

**Representative Hess, prime sponsor – supports.** Discussed the number of audits done in New Hampshire (increasing lately). There was further in depth discussion of the details of the bill. Questions about whether this would change the audit procedure. Answer: No. Comments about comparing this taxation with other states and their income taxes. A question on whether the impact on the state revenues would be larger. Answer: Some lower revenue would be expected. The possibility of lost revenue exists, but we have no actual evidence of a particular number. This law should not be retroactive.

**Representative Stepanek, co-sponsor – supports.** He gave an example of how reasonable compensation and an audit affected him.

DRA discussed the fiscal note and discussion of how many audits are done by the DRA and also commentary of burden of proof.

Respectfully submitted,

  
Representative Russell Ober, Clerk

HOUSE COMMITTEE ON WAYS AND MEANS

PUBLIC HEARING ON HB 611-FN-A

BILL TITLE: relative to determination of the reasonable compensation deduction under the business profits tax.

DATE: 3/9/11

LOB ROOM: 202

Time Public Hearing Called to Order: 10:03

Time Adjourned: 11:26

(please circle if present)

Committee Members: Reps. Stepanek, Major, Griffin, Hess, Sapareto, Uley, Osgood, Ober, Abrami, Azarian, Daugherty, McDonnell, Murphy, Ohm, Sanborn, Shuler, Almy, Hamm, Butynski, Hatch and Cooney

Bill Sponsors: Reps. Hess, Merr 9; Chandler, Carr 1; Bettencourt, Rock 4; Stepanek, Hills 6; Kurk, Hills 7; Sens. Bradley, Dist 3; Rausch, Dist 19; Sanborn, Dist 7

TESTIMONY

\* Use asterisk if written testimony and/or amendments are submitted.

Rep Sapareto - ~~introduced~~ introduced bill noted amendment discussion of bill and what reasonable compensation consists of this bill is the same as SB 25

comments about burden of proof on taxpayer vs. DRA  
Wright / <sup>Max and Fenton</sup> ~~add section~~ <sup>Section 2</sup> DRA  
question about amount of evidence that must be shown by DRA  
LLC's are not a filter of taxes in the state of N.H.

Rep Hess - sponsor  
discussed number of audits done in N.H. (increasing lately)  
further in depth discussion of details of bill  
Questions about whether this would change the audit procedure <sup>for</sup> no  
comments about comparing this taxation with other states and their income taxes  
Question about whether the impact on state ~~revenue~~ revenues would be large.  
Ans. Some lower revenue would be expected

the possibility of lost revenue exists, but we have no actual evidence of a particular number.

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This law should not be retroactive

Rep Stepanek - cosponsor

gave personal example of how reasonable compensation and an audit affected him.

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back to DRA

discussed fiscal note

discussion of how many audits are done by DRA also commentary of burden of proof.

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# Sub-Committee Minutes



HOUSE COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEE WORK SESSION ON HB 611

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** September 25, 2012

**Subcommittee Members:** Reps. Sapareto, Azarian, Shuler, Hatch, and Ohm

**Comments and Recommendations:** Recommend for future legislation. Applicability needs to be update.

**Amendments:**

Sponsor: Rep. OLS Document #:

Sponsor: Rep. OLS Document #:

Sponsor: Rep. OLS Document #:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep. Azarian

Seconded by Rep. Shuler

Vote: 4-1

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote:

Respectfully submitted,

Rep.  
Subcommittee Chairman/Clerk

HOUSE COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEE WORK SESSION ON HB 611

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** 9/25/12

**Subcommittee Members:** Reps. Separeo, Azarian, Schyler, Hetch, Ohm

**Comments and Recommendations:** Recommended for Future Legislation  
Applicability needs to be updated.

**Amendments:**

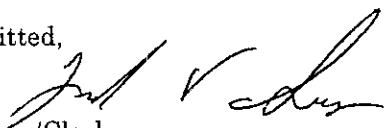
Sponsor: Rep.	OLS Document #: 0696
Sponsor: Rep.	OLS Document #:
Sponsor: Rep.	OLS Document #:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep. Rep Azarian  
Seconded by Rep. Rep Schyler  
Vote: 4-1

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.  
Seconded by Rep.  
Vote:

Respectfully submitted,  
Rep.   
Subcommittee Chairman/Clerk

HOUSE COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEE WORK SESSION ON HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** October 2, 2012

**Subcommittee Members:** Reps. Sapareto, Azarian, Shuler, Hatch, and Ohm

**Comments and Recommendations:**

**Amendments:**

Sponsor: Rep.	OLS Document #:
Sponsor: Rep.	OLS Document #:
Sponsor: Rep.	OLS Document #:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote:

Respectfully submitted,

Rep.  
Subcommittee Chairman/Clerk

**HOUSE COMMITTEE ON WAYS AND MEANS**  
**SUBCOMMITTEE WORK SESSION ON HB 611-FN-A**

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** October 2, 2012

**Subcommittee Members:** Reps. Sapareto, Azarian, Shuler, + Hatch, Ohm

**Comments and Recommendations:**

**Amendments:**

Sponsor: Rep.	OLS Document #:
Sponsor: Rep.	OLS Document #:
Sponsor: Rep.	OLS Document #:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote:

Respectfully submitted,

Rep.  
Subcommittee Chairman/Clerk

# Testimony

- (1) The exclusion of any one or more of the apportionment factors;
- (2) The inclusion of one or more additional apportionment factors which will fairly represent the business organization's business activity in the state; or
- (3) The employment of any other method to effect an equitable apportionment of the business organization's gross business profits.

(b) For foreign dividends from unitary sources, the following formula shall be used to modify factors relating to included dividends:

- (1) Determine a percentage for each dividend payor consisting of dividends paid divided by taxable income which has been computed using United States standards.
- (2) Apply this percentage to the dividend payor's foreign property, payroll, and sales.
- (3) Sum the results in subparagraph (2) for all dividend payors.
- (4) Add the result in subparagraph (3) to the denominators of the combined water's edge group. The numerator will remain the New Hampshire numerator.
- (5) Apply the resulting percentage to the foreign dividends.
- (6) Add this amount to the amount of New Hampshire taxable business profits computed pursuant to RSA 77-A:3, I and II(a).

III. When 2 or more related business organizations are engaged in a unitary business, as defined in RSA 77-A:1, XIV, a part of which is conducted in this state by one or more members of the group, the income attributable to this state shall be determined by means of the combined apportionment factors of the unitary business group in accordance with paragraphs I and II.

IV. The business organization is entitled to a hearing by the commissioner on request in connection with any change in its apportionment procedure and has the right of appeal from the commissioner's determination as provided in RSA 21-J:28-b.

**Source.** 1970, 5:1. 1971, 515:3. 1973, 544:9. 1979, 446:2, 3. 1981, 445:4. 1986, 153:5. 1991, 163:16; 354:7, 16. 1993, 350:11; 350:12. 1999, 346:2, eff. July 1, 1999 at 12:01 a.m.

#### Section 77-A:4

**77-A:4 Additions and Deductions.** – The following adjustments shall be made to gross business profits in determining taxable business profits:

I. In the case of a business organization which is subject to taxation under RSA 77, a deduction of such amount of gross business profits as is attributable to income which is taxable or is specifically exempted from taxation under RSA 77.

II. A deduction of such amount of gross business profits as is attributable to income derived from interest on notes, bonds or other securities of the United States.

[Introductory paragraph of par. III through III(e) apply for taxable periods beginning on or after January 1, 2010; see applicability note below.]

III. In the case of any business organization filing a business profits tax return as a proprietorship or partnership, a deduction for an amount equal to a fair and reasonable compensation for the personal services of the proprietor, partners, or members who are natural persons actually devoting time and effort in the operation of the business organization; provided, however, that nothing contained in this section shall permit the deduction of amounts that are attributable to an owner's return on investment of capital in the business organization in determining taxable business profits. The business organization shall bear the burden of proof in demonstrating the reasonableness of any compensation deduction taken under this paragraph.

(a) The purpose of this paragraph is to permit a deduction from gross business profits of a business organization filing as a proprietorship or partnership, only of such amounts as are fairly attributable to

the personal services of a proprietor, partner, or member and which such individual or individuals might reasonably earn in total compensation if performing like services as an employee or employee-owner of a corporation so that amounts attributable to the provision of personal services are determined in the same manner regardless of the form of entity through which the business activities are conducted.

(b) Reasonable compensation deductions may reduce a business organization's taxable business profits below zero for any taxable period only if such compensation has actually been paid.

(c) The amount of the deduction allowed under this paragraph shall be determined, as applicable to the tax structure of the state of New Hampshire, using the standards set forth in section 162(a)(1) of the United States Internal Revenue Code, as it may be amended from time to time, and the Treasury Regulations, administrative rulings, and judicial cases issued thereunder.

(d) The amount of any deduction claimed for reasonable compensation under this section may also include an amount not to exceed 15 percent of the gross selling price as commission on the sale of business assets.

(e) Each business organization claiming a compensation deduction under RSA 77-A:4, III shall provide on a schedule attached to its annual return setting forth the following information:

(1) The total reasonable compensation deduction claimed by the business organization for the tax year; and

(2) The amount of such deduction allocated to each proprietor, partner, or member actually devoting time and effort in the operation of the business organizations entitled to the deduction.

[Paragraphs III(f) through III(i) apply for taxable periods beginning on or after January 1, 2011; see applicability note below.]

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

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

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

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

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

IV. [Repealed.]

V. [Repealed.]

VI. [Repealed.]

VII. In the case of a business organization which takes any deduction for a net income tax, a franchise

**402:2 Effective Date.** This act shall take effect July 1, 1973.

[Approved June 29, 1973.]  
[Effective date July 1, 1973.]

### CHAPTER 403.

#### AN ACT SPECIFYING CERTAIN DEDUCTIONS WHICH MUST BE ALLOWED PROPRIETORSHIPS AND PARTNERSHIPS IN CALCULATING THE BUSINESS PROFITS TAX.

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

**403:1 Deductions for Proprietorships and Partnerships.** Amend RSA 77-A:4, IV (supp) as inserted by 1970, 5:1, as amended, by striking out in line thirteen the word "may" and inserting in place thereof the following (shall), and by inserting in line fourteen after the word "employees" the following (the proprietor or any of the partners), and by striking out in line fourteen the words "use of its" and inserting in place thereof the following (use of their) so that said paragraph as amended shall read as follows:

IV. In the case of a sole proprietorship, including farm proprietorship, or partnership, a deduction equal to a fair and reasonable compensation for the personal services of the proprietor or partners actually devoting time and effort in the operation of the enterprise. The purpose of this paragraph is to permit deduction from gross business profits of a proprietorship or partnership only of such amounts as are fairly attributable to the personal services of the proprietor or partners. In the event there is occasion to determine the reasonableness of deduction claimed under this paragraph the commissioner shall consider the claimed deduction in light of compensation for personal services of employees in positions requiring similar responsibility, devotion of time, education and experience in business organizations of similar size, volume and complexity. In addition, the commissioner shall take into account the value to the proprietorship or partnership of the labor of its employees, the proprietor or any of the partners, and the use of their property and any other factor which may reasonably assist the commissioner in making a determination. ~~Such deduction as is claimed by the taxpayer shall be deemed reasonable unless the commissioner finds, by a preponderance of the evidence upon the standards herein set forth and after notice and hearing that the claimed deduction is grossly excessive.~~ Provided, that a taxpayer ascertaining its gross business profits in this state by the allocation procedure established in RSA 77-A:3 is allowed only such percentage of the deductions allowable in paragraphs II, III and IV of this section as has been applied by it in ascertaining its gross business profits in this state. Provided further that subject to the preceding sentence, a minimum deduction of three thousand dollars shall be allowed on account of the proprietor or each partner actually devoting time and effort in the operation of the enterprise.

**403:2 Effective Date.** This act shall take effect July 1, 1973.

[Approved June 29, 1973.]  
[Effective date July 1, 1973.]



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.

- 1. FN - ?
- 2. IRC §162(a) provision unworkable
- 3. Restore a level playing field for TPA.  
- Cost to fight > tax cleared
- 4. Don't double tax entrepreneurs  
Both BPU & TPA tax
- 5. You don't calculate comp of owner/partner to a simple impact
- 6. Generally accept Fed tax filing: 20 comp: : Inc tax + FICA

MARCH 9, 2011  
February 11, 2010

To: House Ways and Means Committee  
From: Rep. David W. Hess

HB 611

1. Sharing the Burden between the taxpayer and the DRA to Prove that Claimed Compensation is Not Fair and Reasonable

Under current law the business organization has the burden of proving that a compensation deduction is reasonable. This proposal does not shift the burden of proof entirely from the tax payer to the DRA. Rather, this would place the burden, in the first instance, on the taxpayer to submit some evidence to support its claim of reasonable compensation. After that submission, the burden would then shift to the DRA to prove that the claimed compensation was unreasonable. Therefore, this would represent a change—but for several very good reasons.

First, current bills seek to extend the DRA's oversight power to bureaucratically determine what is "reasonable compensation" to more and more, and smaller and smaller businesses—ensnaring tens of thousands of small closely held LLCs and partnerships in the DRA's audit net for the first time. These business organizations have far fewer resources than DRA to address the issues of "reasonable compensation." Indeed the legal and investigative resources of the DRA literally dwarf those of the businesses they will be auditing. Given the reality of this unlevel playing field, it is only fair and a matter of common sense that DRA should bear this burden.

Placing this burden on DRA also substantially reduces the moral hazard that would ensue if the burden of proof is unchanged. By moral hazard, I mean the situation that will rise with increasing frequency when the DRA claims compensation is unreasonable and the taxpayer either cannot or decides not to contest that determination because of the cost to do so is either prohibitive, or far exceeds the increased tax liability resulting from the DRA's determination.

Finally, if as seems likely, the provisions of IRC §162 and its regulations and case law are added as a criteria to be considered in determining reasonable compensation, the imbalance in resources between the DRA and the taxpayer is substantially widened. Those sources are enough to literally fill shelf upon shelf in a library, and their esoteric content are known and understood only by highly paid specialists and experts. The burden should be on the DRA to search through the sources to find a justification for its position, not the taxpayer.

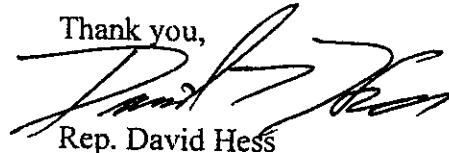
2. If the Primary Purpose of this Bill is to Tax Passive Income not Earned by Personal Service, Then Just Say It

The DRA has repeatedly testified that it does not do "compensation audits." It has said that the sister legislation to this bill, the newly expanded dividends tax on partnerships and LLCs, is aimed at taxing passive income distributions to partners and members who have not rendered personal services to their partnership or LLC. And it has strongly implied that it does not expect or intend to generally challenge claimed compensation deductions for partners and members who render personal services in this business. So let's just say that in the

statute, if a taxpayer in fact renders personal services to his partnership, LLC or sole proprietorship, receives compensation for those services, and pays social security and Medicare taxes or that compensation, then that compensation shall be presumed fair and reasonable.

✓ **3. Third, it deletes the reference to "employee or" on p.2 line 28.** This addresses the concern of another tax practitioner who testified that nowhere else in our tax-law universe is the compensation of a simple employee used as a standard to determine what is fair and reasonable compensation for an entrepreneur—owner or owner-employee of a small business. The compensation of a 40-hour-a-week employee would command to perform a set of tasks is not even closely comparable to what is reasonable compensation for an owner-employee who worries about making his weekly payroll, lies awake nights thinking about how he can expand his customers, and takes out a second mortgage on his house to keep his business afloat or

Thank you,



Rep. David Hess

# Voting Sheets

HOUSE COMMITTEE ON WAYS AND MEANS

EXECUTIVE SESSION on HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** March 9, 2011

**LOB ROOM:** 202

**Amendments:**

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

**Motions:** OTP, OTP/A, ITL, Interim Study, Retain (Please circle one.)

Moved by Rep. Hess

Seconded by Rep. Sapareto

Vote: 18-2 (Please attach record of roll call vote.)

**Motions:** OTP, OTP/A, ITL, Interim Study (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote: (Please attach record of roll call vote.)

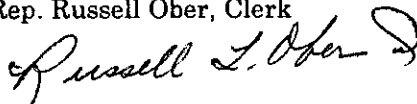
**CONSENT CALENDAR VOTE:**

(Vote to place on Consent Calendar must be unanimous.)

**Statement of Intent:** Refer to Committee Report

Respectfully submitted,

Rep. Russell Ober, Clerk



HOUSE COMMITTEE ON WAYS AND MEANS

EXECUTIVE SESSION on HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:**

3/9/11

**LOB ROOM:** 202

Amendments:

Sponsor: Rep.

~~Hess~~

OLS Document #:

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

Motions: OTP, OTP/A, ITL, Interim Study (Please circle one.)

retain

Moved by Rep. Hess

Seconded by Rep. Sapareto

Vote: 18-2 (Please attach record of roll call vote.)

Motions: OTP, OTP/A, ITL, Interim Study (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote: (Please attach record of roll call vote.)

**CONSENT CALENDAR VOTE:**

(Vote to place on Consent Calendar must be unanimous.)

Statement of Intent: Refer to Committee Report

Respectfully submitted,

Rep. Russell Ober, Clerk

HOUSE COMMITTEE ON WAYS AND MEANS

EXECUTIVE SESSION on HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** October 27, 2011

**LOB ROOM:** 202

**Amendments:**

Sponsor: Rep. OLS Document #:

Sponsor: Rep. OLS Document #:

Sponsor: Rep. OLS Document #:

**Motions:** OTP, OTP/A, ITL, Interim Study (Please circle one.)

Moved by Rep. Hess

Seconded by Rep. Daugherty

Vote: 20-0 (Please attach record of roll call vote.)

**Motions:** OTP, OTP/A, ITL, Interim Study (Please circle one.)

Moved by Rep:

Seconded by Rep.

Vote: (Please attach record of roll call vote.)

**CONSENT CALENDAR VOTE: YES**

(Vote to place on Consent Calendar must be unanimous.)

**Statement of Intent:** Refer to Committee Report

Respectfully submitted,

Rep. Russell Ober, Clerk

HOUSE COMMITTEE ON WAYS AND MEANS

EXECUTIVE SESSION on HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** October 27, 2011

**LOB ROOM:** 202

**Amendments:**

Sponsor: Rep. *Hess* OLS Document #:

Sponsor: Rep. OLS Document #:

Sponsor: Rep. OLS Document #:

**Motions:** OTP, OTP/A, ITL, Interim Study (Please circle one.)

Moved by Rep. *Hess*

Seconded by Rep. *Daugherty*

Vote: (Please attach record of roll call vote.)

**Motions:** OTP, OTP/A, ITL, Interim Study (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote: (Please attach record of roll call vote.)

**CONSENT CALENDAR VOTE:**

(Vote to place on Consent Calendar must be unanimous.)

**Statement of Intent:** Refer to Committee Report

Respectfully submitted,

Rep. Russell Ober, Clerk



WAYS AND MEANS

Bill #: HB611 Title: relative to the determination of the reasonable comp

PH Date: 3 19 11 Exec Session Date: 10 1 27 11

Motion: Interim Study Amendment #: \_\_\_\_\_

MEMBER	YEAS	NAYS
Stepanek, Stephen B, Chairman	✓	
Major, Norman L, V Chairman	✓	
Griffin, Mary E	✓	
Hess, David W	✓	
Sapareto, Frank V	✓	
Ulery, Jordan G	✓	
Osgood, Joe	✓	
Ober, Russell T, Clerk	✓	
<del>Abrami, Patrick F</del> <u>Eliot, Robert</u>		
Azarian, Gary S	✓	
Daugherty, Duffy	✓	
McDonnell, John J	✓	
Murphy, Keith	✓	
Ohm, Bill	✓	
Sanborn, Laurie J	✓	
Shuler, Wyman E	✓	
Almy, Susan W	✓	
Hamm, Christine C	✓	
Butynski, William	✓	
<del>Hatch, William A</del> <u>Handis, Laurie</u>	✓	
Cooney, Mary R	✓	
TOTAL VOTE:		

20-0

HOUSE COMMITTEE ON WAYS AND MEANS

EXECUTIVE SESSION on HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** October 24, 2012

**LOB ROOM:** 202

**Amendments:**

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep. Sapareto

Seconded by Rep. Azarian

Vote: 11-4 (Please attach record of roll call vote.)

**Motions:** Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote: (Please attach record of roll call vote.)

**CONSENT CALENDAR VOTE:**

(Vote to place on Consent Calendar must be unanimous.)

**Statement of Intent:** Refer to Committee Report

Respectfully submitted,

Rep. Russell Ober, Clerk

HOUSE COMMITTEE ON WAYS AND MEANS

EXECUTIVE SESSION on HB 611-FN-A

**BILL TITLE:** relative to determination of the reasonable compensation deduction under the business profits tax.

**DATE:** October 24, 2012

**LOB ROOM:** 202

Amendments:

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

Sponsor: Rep.

OLS Document #:

Motions: Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep. *Sapareto*

Seconded by Rep. *AZARIAN*

Vote: *11-4* (Please attach record of roll call vote.)

Motions: Recommended or Not Recommended for Future Legislation (Please circle one.)

Moved by Rep.

Seconded by Rep.

Vote: (Please attach record of roll call vote.)

CONSENT CALENDAR VOTE:

(Vote to place on Consent Calendar must be unanimous.)

Statement of Intent: Refer to Committee Report

Respectfully submitted,

Rep. Russell Ober, Clerk

WAYS AND MEANS

Bill #: HB611 Title: relative to determination of reasonable compensation

PH Date:      /      /      Exec Session Date: 10 / 24 / 12

Motion: \_\_\_\_\_ Amendment #: \_\_\_\_\_

MEMBER	YEAS	NAYS
Stepanek, Stephen B, Chairman	✓	
Major, Norman L, V Chairman	✓	
Griffin, Mary E	✓	
Hess, David W	✓	
Sapareto, Frank V	✓	
<del>Ulery, Jordan G</del>		
<del>Osgood, Joe</del>		
Ober, Russell T, Clerk	✓	
Abrami, Patrick F	✓	
Azarian, Gary S	✓	
Daugherty, Duffy	✓	
<del>McDonnell, John J</del>		
<del>Murphy, Keith</del>		
Ohm, Bill	✓	
Shuler, Wyman E <i>KAPLEN</i>	✓	
Almy, Susan W		✓
<del>Hamm, Christine C</del>		
Butynski, William		✓
Hatch, William A		✓
Cooney, Mary R		✓

11-4

# Committee Report

**CONSENT CALENDAR**

**November 3, 2011**

**HOUSE OF REPRESENTATIVES**

**REPORT OF COMMITTEE**

**The Committee on WAYS AND MEANS to which was referred HB611-FN-A,**

**AN ACT relative to determination of the reasonable compensation deduction under the business profits tax.**

**Having considered the same, report the same with the recommendation that the bill be REFERRED FOR INTERIM STUDY.**

**Rep. David W Hess**

**FOR THE COMMITTEE**

## COMMITTEE REPORT

Committee:	WAYS AND MEANS
Bill Number:	HB611-FN-A
Title:	relative to determination of the reasonable compensation deduction under the business profits tax.
Date:	November 3, 2011
Consent Calendar:	YES
Recommendation:	REFER TO COMMITTEE FOR INTERIM STUDY

### STATEMENT OF INTENT

Last spring, we thought we had addressed the issue of reasonable compensation as a deduction from business income for sole proprietorships, partnerships, limited liability corporations and other small businesses by passing SB 125. Unfortunately, tax preparers and others have reported that DRA may be interpreting SB 125 contrary to the legislative intent of this Committee, the full House and the Senate. By sending this bill to Interim Study, we can fully and thoroughly investigate these reports and, if accurate, use HB 611 to unequivocally and unambiguously remedy any misunderstanding of the legislative intent on this article taxation issue for small businesses.

Vote 20-0.

Rep. David W Hess  
FOR THE COMMITTEE

Original: House Clerk  
Cc: Committee Bill File

## CONSENT CALENDAR

### WAYS AND MEANS

**HB611-FN-A**, relative to determination of the reasonable compensation deduction under the business profits tax. **REFER TO COMMITTEE FOR INTERIM STUDY.**

Rep. David W Hess for WAYS AND MEANS. Last spring, we thought we had addressed the issue of reasonable compensation as a deduction from business income for sole proprietorships, partnerships, limited liability corporations and other small businesses by passing SB 125. Unfortunately, tax preparers and others have reported that DRA may be interpreting SB 125 contrary to the legislative intent of this Committee, the full House and the Senate. By sending this bill to Interim Study, we can fully and thoroughly investigate these reports and, if accurate, use HB 611 to unequivocally and unambiguously remedy any misunderstanding of the legislative intent on this article taxation issue for small businesses. **Vote 20-0.**

Original: House Clerk  
Cc: Committee Bill File



## HB 611

### Interim Study

Last spring, we thought we had addressed the issue of reasonable compensation as a deduction from business income for sole proprietorships, partnerships, limited liability corporations and other small businesses by passing SB 125. Unfortunately, tax preparers and others have reported that DRA may be interpreting SB 125 contrary to the legislative intent of this Committee, the full House and the Senate. By sending this bill to Interim Study, we can fully and thoroughly investigate these reports and, if accurate, use HB 611 to unequivocally and unambiguously remedy any misunderstanding of the legislative intent on this article taxation issue for small businesses.

David Hess

Hess  
HB-611

# COMMITTEE REPORT

COMMITTEE: House WAYS & MEANS

BILL NUMBER: HB 611-FINAL

TITLE: Relative to determination of the reasonable compensation deduction under the business profits tax

DATE: 10/27/11 CONSENT CALENDAR: YES  NO

OUGHT TO PASS

OUGHT TO PASS W/ AMENDMENT

INEXPEDIENT TO LEGISLATE

INTERIM STUDY (Available only 2<sup>nd</sup> year of biennium)

Amendment No. _____
------------------------

## STATEMENT OF INTENT:

Last spring, we thought we had addressed the issue of reasonable compensation ~~and~~ deduction from business income for sole proprietorships, partnerships, limited liability corporations + other small businesses by passing SB 125. Unfortunately, tax preparers + others have reported that DRAs may be interpreting SB 125 contrary to the legislative intent of this Committee, the Full House + the Senate. By sending this bill to Interim Study, we can fully + thoroughly investigate these reports + if accurate use HB 611 to unequivocally + unambiguously remedy any misunderstanding.

COMMITTEE VOTE: 20-0 (over)

RESPECTFULLY SUBMITTED,

- Copy to Committee Bill File
- Use Another Report for Minority Report

Rep. David W. Hess  
For the Committee

OK  
SBS

of the legislative intent on this critical taxation issue  
for small businesses.

## INTERIM STUDY COMMITTEE REPORT

COMMITTEE:           WAYS AND MEANS  
BILL NUMBER:        HB 611-FN-A  
TITLE:                Relative to determination of the reasonable compensation deduction  
                          under the business profits tax.  
DATE:                October 24, 2012

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**RECOMMENDED FOR FUTURE LEGISLATION**

**NOT RECOMMENDED FOR FUTURE LEGISLATION**

---

STATEMENT OF INTENT:       (May be handwritten)

HB 611 is necessary because the DRA continually makes rules that occasionally violate legislative intent. It clarifies legislative intent on the reasonable compensation issue. The legislature has placed the burden of proving compensation above the \$50,000 threshold on the DRA. Often their rules thwart this process. HB 611 on subsequent bills will provide a mechanism for "tweaking" the law and keeping the DRA in check.

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COMMITTEE VOTE:    11-4    (Attach Committee Voting Sheet)

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Rep. Frank V. Sapareto

# INTERIM STUDY COMMITTEE REPORT

COMMITTEE: WE, M  
 BILL NUMBER: HB 611  
 TITLE: \_\_\_\_\_  
 DATE: 10/24/12

**RECOMMENDED FOR FUTURE LEGISLATION**

**NOT RECOMMENDED FOR FUTURE LEGISLATION**

STATEMENT OF INTENT: (May be handwritten)

HB 611 is necessary because the DRA continually makes rules that occasionally violate legislative intent. It clarifies legislative intent on the reasonable compensation issue. The legislature has placed the burden of proving compensation above the \$50,000 threshold on the DRA. Often their rules thwart this process. HB 611 or subsequent bills will provide a mechanism for "tweaking" the law and keeping the DRA in check.

COMMITTEE VOTE: 11-4 (Attach Committee Voting Sheet)

OK  
SBS

Rep. [Signature]  
For the Committee