

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION**

IN THE MATTER OF THE PETITION OF

ABC, Inc., 123, LLC and an Individual

FOR A DECLARATORY RULING

REDACTED DOCUMENT

Document # 10391 Effective 7/26/2013

Pursuant to RSA 541-A:1, IV and RSA 541-A:16, II(b) and N.H. Code of Admin. Rules Rev 209.01, the Petitioners request a declaratory ruling with respect to business profits tax, business enterprise tax, real estate transfer tax, and interest and dividends tax.

Pursuant to N.H. Code of Admin. Rules Rev 209.02, this declaratory ruling is issued to the Petitioners with respect to the particular circumstances and facts discussed herein and represents a holding of the department on those circumstances and facts for those Petitioners only.

FACTS PRESENTED BY THE PETITIONERS

ABC, Inc. was formed to engage in the real estate business, including leasing real property. It has elected to be treated as a Subchapter S Corporation for Federal income tax purposes and operates on a calendar year basis for accounting and tax purposes. It files corporate BPT and BET returns with the Department using the cash method of reporting income. ABC, Inc. has issued 60% of its shares to a grantor trust, of which the individual Petitioner and spouse are co-trustees, and 40% of its remaining shares to two individuals at 20% each. All of ABC, Inc.'s shareholders are New Hampshire residents, who each report distributions for Interest and Dividends Tax ("I&D") purposes to the extent they meet the filing threshold, pursuant to RSA 77:3, I, in any given tax period.

ABC, Inc.'s shareholders seek to convert the entity to a New Hampshire limited liability company, 123, LLC, as a statutory conversion, pursuant to RSA 304-C:147 through 149, in accordance with the following representations:

1. As members of 123, LLC, the shareholders of ABC, Inc. will have identical ownership percentages of the business in 123, LLC as currently exists in ABC, Inc.;
2. The shareholders of ABC, Inc. will receive no consideration other than the membership interest in 123, LLC in exchange for their stock in ABC, Inc.;
3. The shareholders of ABC, Inc. have no present plan or intention to sell, exchange or otherwise dispose of the membership interest they will receive in the conversion of ABC, Inc.;
4. Immediately after the conversion, the shareholders of ABC, Inc. will own all of the membership interest in 123, LLC;
5. ABC, Inc. has no present plan or intention to reacquire or redeem any of the ABC, Inc. shares;
6. 123, LLC has no present plan or intention to reacquire or redeem any of the membership interests issued in the conversion;

7. 123, LLC will not issue any membership interests to persons or entities other than the shareholders of ABC, Inc. as part of the conversion;
8. 123, LLC has no present plan or intention to sell, transfer or otherwise dispose of any of the assets obtained through the conversion;
9. The fair market value of the assets held by ABC, Inc. will be the fair market value of the assets held by 123, LLC;
10. Under RSA 304-C:147, 123, LLC remains the same business entity after the statutory conversion as it was before;
11. After the statutory conversion, 123, LLC will conduct the same business activity as ABC, Inc. conducted before;
12. 123, LLC will elect under Treas. Reg. §301.7701-3 to be treated as an association taxable as a corporation and such election shall be effective as of the date of the conversion such that 123, LLC will never exist as a partnership for purposes of federal taxation;
13. 123, LLC members will all be persons eligible to be shareholders of a small business corporation pursuant to the requirements of IRC §1361(b); and
14. 123, LLC will retain the FEIN assigned to ABC, Inc. under Rev. Rul. 73-526.

In addition to making the above representations, the Petitioners submitted all of the statutory conversion documentation that will be executed to effectuate the conversion, as well as certain documentation relative to ABC, Inc.

DETERMINATION REQUESTED BY THE PETITIONERS

Petitioners request the following rulings:

1. The conversion of ABC, Inc. from a New Hampshire business corporation to 123, LLC to a New Hampshire limited liability company, under the provisions of RSA 304-C:147 through 149 shall not create any gross business profits or taxable business profits to ABC, Inc. or 123, LLC since the conversion qualifies as a tax free corporate reorganization under IRC §368(a)(1)(F).
2. The conversion of ABC, Inc. from a New Hampshire business corporation to 123, LLC to a New Hampshire limited liability company, under the provisions of RSA 304-C:147 through 149 shall not create any dividends includable in the enterprise value tax base of ABC, Inc. or 123, LLC for purposes of the BET since the conversion qualifies as a tax free corporate reorganization under IRC §368(a)(1)(F).
3. 123, LLC shall continue to file the required BPT and BET returns using:
 - a. The same FEIN that ABC, Inc. previously used;
 - b. The same taxable period that ABC, Inc. previously used; and
 - c. The corporate business tax forms that ABC, Inc. previously used.
4. 123, LLC shall file a single business tax return for the calendar year covering the days before and the days after the statutory conversion.
5. Any BET credits earned by ABC, Inc. and being carried forward at the time of the conversion shall be available for use by 123, LLC based on the original carry forward periods of the credits.
6. The conversion of ABC, Inc. to 123, LLC under the provisions of RSA 304-C:147 through 149 shall not create a taxable transfer of the real estate owned by ABC, Inc. for purposes of the real estate transfer tax.

7. The conversion of ABC, Inc. to 123, LLC under the provisions of RSA 304-C:147 through 149 shall not create dividend income to the shareholders of ABC, Inc. since the conversion qualifies as a tax free corporate reorganization under IRC § 368(a)(1)(F).
8. ABC, LLC will have non-transferable membership interest and, accordingly, distributions from 123, LLC shall not be considered dividends to the New Hampshire resident members of 123, LLC for purposes of the I&D tax.
9. 123, LLC will be considered a taxable entity under RSA 77:3, I(b) to the extent that it receives more than \$2,400 in interest and/or dividend income in any taxable period.

REVISED STATUTES ANNOTATED (RSA) AT ISSUE

The following New Hampshire statutes are relevant to the Petitioners' request for a declaratory ruling:

RSA 77:3-a (2012)
RSA 77:4, II and III (2012)
RSA 77-A:1, III, IV, and XX (2012)
RSA 77-A:2
RSA 77-A:3
RSA 77-A:4 (2012)
RSA 77-E:1, VI, IX, and XV (2012)
RSA 77-E:2
RSA 77-E:3
RSA 77-E:4
RSA 78-B:1-a, II, IV, and V (2012)
RSA 304-C:147 (2012)
RSA 304-C:148, II (2012)
RSA 304-C:149 (2012)

OTHER LAWS OR RULES

IRC §361
IRC §368(a)(1)(F)
IRC §1361
Treas. Reg. 301.7701-3
N.H. Code of Admin. Rules Rev 302.01
N.H. Code of Admin. Rules Rev 307.02(b)&(d)
N.H. Code of Admin. Rules Rev 901.02, (a)&(b)
N.H. Code of Admin. Rules Rev 901.07
N.H. Code of Admin. Rules Rev 901.08
N.H. Code of Admin. Rules Rev 902.07(a)
N.H. Code of Admin. Rules Rev 2402.03
N.H. Code of Admin. Rules Rev 2405.04(c)
N.H. Code of Admin. Rules Rev 2407.03(a)

PETITIONERS' REPRESENTATIONS

To the best of the Petitioners' knowledge, the issues that are the subject of this petition:

- a. Are not under examination by the Department;

- b. Have not been examined by the Department;
- c. Are not under consideration by the Department in connection with a return of a prior period; and
- d. Are not pending in litigation.

DISCUSSION

A. Business Profits Tax

Pursuant to RSA 77-A:2, the Business Profits Tax (“BPT”) is “[a] tax...imposed at the rate of 8.5 percent upon the taxable business profits of every business organization.” “Taxable business profits” is defined as “gross business profits adjusted by the additions and deductions provided in RSA 77-A:4 and then adjusted by the method of apportionment provided in RSA 77-A:3.” See RSA 77-A:1, IV (2012). “Gross business profits” is defined as “[i]n the case of “S” corporations or any other business organization required to make and file an “S” corporation return, the net profit from all business activity determined in accordance with rules adopted by the department of revenue administration under RSA 541-A.” See RSA 77-A:1, III (2012). N.H. Code of Admin. Rules Rev 302.01 sets forth the provisions to determine the “net profit from all business activity.” Finally, to arrive at the business organization’s “taxable business profits,” the “gross business profits” must be “adjusted by the additions and deductions provided in RSA 77-A:4.” There is no apportionment issue for the Petitioners, which are 100% New Hampshire business organizations.

The Petitioners represent that the interest exchange will be accomplished through a statutory conversion, pursuant to RSA 304-C:147 through 149. In addition, the Petitioners represent that the interest exchange qualifies as a tax-free corporate reorganization under IRC §368(a)(1)(F) and, therefore, there is no recognition of gain or loss to the Petitioners, pursuant to IRC §361. Further, the Petitioners represent that the limited liability company will elect to be treated as an association taxable as a corporation, in accordance with Treas. Reg. § 301.7701-3, effective as of the date of the conversion and, therefore, will never exist as a partnership for purposes of federal taxation. And, the Petitioners represent the limited liability company members will all be persons eligible to be shareholders of a small business corporation, pursuant to the requirements of IRC §1361(b).

Rev 302.01 does not require the Petitioners to include any revenue attributes from the Petitioners’ interest exchange to the “net profit from all business activity” when determining their “gross business profits. Therefore, the Petitioners have no BPT liability as a result of the statutory conversion.

After the interest exchange through a statutory conversion, 123, LLC will continue to file a NH-1120, pursuant to Rev 307.02(b) and (d), under the same FEIN, as the members of 123, LLC will have identical ownership percentages of the business in 123, LLC as currently exists in ABC, Inc., the shareholders of ABC, Inc. will receive no consideration other than the membership interest in 123, LLC in exchange for their interest in ABC, Inc., in addition to the other representations made by the Petitioners.

B. Business Enterprise Tax

Pursuant to RSA 77-E:2, the Business Enterprise Tax (“BET”) is “[a] tax...imposed at the rate of 3/4 percent upon the taxable enterprise value tax base of every business organization.” “Taxable enterprise value tax base” is defined as “the enterprise value tax base adjusted by the special adjustments provided in RSA 77-E:3 and then adjusted by the method of apportionment provided in RSA 77-E:4.” See RSA 77-E:1, XV (2012). “Enterprise value tax base” is defined as “the sum of all compensation paid or accrued, interest paid or accrued, and dividends paid by the business enterprise, before special

adjustments provided in RSA 77-E:3 or apportionment as provided in RSA 77-E:4.” See RSA 77-E:1, IX (2012). “Dividends” is defined as “any distribution of money or property, other than the distribution of newly issued stock of the same enterprise, to the owners of a business enterprise with respect to their ownership interest in such enterprise from the accumulated revenues and profits of the enterprise.” See RSA 77-E:1, VI (2012). Finally, to arrive at the business enterprise’s “taxable enterprise value tax base,” the “enterprise value tax base” must be “adjusted by the special adjustments provided in RSA 77-E:3 and then adjusted by the method of apportionment provided in RSA 77-E:4.” There is no apportionment issue for the Petitioners which are 100% New Hampshire business enterprises.

The Petitioners represent that the interest holders will receive no distributions of money or property as a result of the interest exchange. Therefore, the Petitioners represent that the interest holders will receive no dividends as a result of the interest exchange. See RSA 77-E:1, VI (2012) and Rev 2402.03. Further, the special adjustments provided in RSA 77-E:3 are not applicable to the facts as presented by the Petitioners. Therefore, the interest exchange will not create any enterprise value tax base subject to the BET.

After the interest exchange through a statutory conversion, 123, LLC will continue to file a NH BET return pursuant to Rev 2407.03(a). Further, 123, LLC shall not lose the unused BET credits available to ABC, Inc. at the time of the statutory conversion and shall determine the expiration date of all unused credits based on the original carryover periods of the credits. See Rev 2405.04(c).

C. Real Estate Transfer Tax

Pursuant to RSA 78-B:1(a), the Real Estate Transfer Tax (“RETT”) is “[a] tax...imposed upon the sale, granting and transfer of real estate and any interest therein including transfers by operation of law.” “Sale, granting and transfer” is defined as “every contractual transfer of real estate, or any interest in real estate from a person or entity to another person or entity, whether or not either person or entity is controlled directly or indirectly by the other person or entity in the transfer.” See RSA 78-B:1-a, V (2012). “Contractual transfer” is defined as “a bargained-for exchange of all transfers of real estate or an interest therein...” See RSA 78-B:1-a, II. There is no statutory definition for “a bargained-for exchange.” However, the New Hampshire Supreme Court has held that “a bargained-for exchange is an element of ‘consideration.’” See *First Berkshire Bus. Trust v. Comm’r, N.H. Dep’t of Revenue Admin.*, 161 N.H. 176, 180-181 (2010). *First Berkshire* further provides that RSA 78-B:1-a, IV defines “consideration” as “the amount of money, or other property and services, or property or services valued in money which is given in exchange for real estate, and measured at a time immediately after the transfer of the real estate.” *Id.* at 181. While *First Berkshire* only addresses the first portion of the definition of “consideration,” the remaining portion of the definition is not necessary for this analysis.

The Petitioners represent that the interest holders will have identical ownership percentages of the business in 123, LLC as currently exists in ABC, Inc. and that the interest holders of ABC, Inc. will receive no consideration other than the membership interest in 123, LLC in exchange for their stock in ABC, Inc. Finally, the Petitioners represent that the fair market value of the assets held by ABC, Inc. will be the fair market value of the assets held by 123, LLC. The analysis of whether the Petitioners owe RETT as a result of the statutory conversion has two parts.

The first part of the analysis is whether the statutory conversion is a “contractual transfer,” which is a “bargained-for exchange of real estate.” As provided in *First Berkshire*, “a bargained-for exchange is an element of ‘consideration,’” which definition begins with “the amount of money, or other property and services, or property or services valued in money which is given in exchange for real estate, and measured at a time immediately after the transfer of the real estate.” Here, the Petitioners’ mechanism for conducting the statutory conversion will result in no exchange of money, or other property and services,

etc. Rather, the Petitioners represent that no consideration will be received for the membership interest exchange. Accordingly, there is no consideration in the Petitioners' interest exchange.

The second part of the analysis is whether the transfer of real estate is from one entity to another entity, as required in the definition of a "sale, granting or transfer." The statutory conversion provisions specifically state that "[a] statutory conversion is a procedure (I) which involves only a single business entity; and (II) under which the converting business entity, as defined in RSA 304-C:148, II: (a) converts its business organization form to a different business organization form; but (b) remains the same business entity after the business conversion as before." See RSA 304-C:147 (2012). Accordingly, the transfer of real estate is not a transfer at all, but rather a statutory conversion that involves only a single business entity. Therefore, the Petitioners' interest exchange is not subject to RETT.

D. Interest & Dividends Tax

Pursuant to RSA 77:4, the I&D tax levies a tax upon certain income. The two relevant provisions at issue for the Petitioners concern the taxation of dividends "on shares in all corporations" and "on shares in partnerships, limited liability companies, or associations the beneficial interest in which is represented by transferable shares." RSA 77:4, II and III (2012). Rev 901.08 defines "dividend" as "an amount of property distributed, with respect to their ownership interest, other than in liquidation of the organization, to shareholders or interest-holders of an organization from (a) current year profit; or (b) accumulated profits of such entity." In addition, Rev 901.07 defines "distributions" as "a transfer of property from an organization to its shareholders or interest-holders solely as a result of their ownership interest in such organization."

As discussed above, the Petitioners represent that the interest holders will receive no distributions of money or property as a result of the statutory conversion. Therefore, the Petitioners represent that the interest holders will receive no dividends as a result of the interest exchange. Accordingly, the Petitioners' interest exchange is not subject to I&D tax.

After the statutory conversion, 123, LLC will be a limited liability formed under the provisions of RSA Chapter 304-C. See RSA 77:3-a (2012). Pursuant to RSA 77:3, I,

Taxable income is that income received from interest and dividends during the tax year prior to the assessment date by:

(a) Individuals who are inhabitants or residents of this state for any part of the taxable year whose gross interest and dividend income from all sources, including income from a qualified investment company pursuant to RSA 77:4, V, exceeds \$2,400 during that taxable period.

(b) Partnerships, limited liability companies, and associations, the beneficial interest in which is not represented by transferable shares, whose gross interest and dividend income from all sources exceeds \$2,400 during the taxable year, but not including a qualified investment company as defined in RSA 77-A:1, XXI, or a trust comprising a part of an employee benefit plan, as defined in the Employee Retirement Income Security Act of 1974, section 3.

(c) Executors deriving their appointment from a court of this state whose gross interest and dividend income from all sources exceeds \$2,400 during the taxable year.

Further, Rev 902.07(a) provides that “[t]he interest and dividends tax shall be applied at the: (1) entity level for...LLCs...when: a.) The entity has a usual place of business within New Hampshire...; b.) Any...member...is an inhabitant or resident of New Hampshire; and c.) The ownership interest is not represented by transferable shares.” Pursuant to the Petitioners’ representations, 123, LLC has a usual place of business within New Hampshire and members who are residents of New Hampshire. The remaining part of the analysis is whether 123, LLC’s ownership interest is represented by “transferable shares.” The Petitioners have represented that 123, LLC’s operating agreement will provide that membership interests in the entity shall only be effective “upon the prior unanimous written approval of the members.” Rev 901.02 defines a “beneficial interest in which is not represented by transferable shares” as

[A]n interest in an organization:

(a) Where the shares, equitable interests and all ownership rights are not transferable without obtaining prior member approval or causing a dissolution of the organization; and

(b) Which is not a:

- (1) Business trust;
- (2) Common law trust;
- (3) Massachusetts trust;
- (4) Real estate investment trust;
- (5) Corporation;
- (6) Joint stock company; or
- (7) Homeowners or condominium association.

See also, *N.H. Resident L.P. of the Lyme Timber Co. v. N.H. Dep’t of Revenue Admin.*, 162 N.H. 98, 103 (2011). Based on the Petitioners’ representations, the interests in 123, LLC will not be transferable without obtaining prior member approval. See Rev 901.02(a). In addition, 123, LLC is not an entity listed in Rev 901.02(b). Therefore, the I&D tax shall be applied at the entity level of 123, LLC when the gross interest and dividend income from all sources exceeds \$2,400 during the taxable year. 123, LLC will have non-transferable membership interests and, accordingly, distributions from 123, LLC shall not be considered dividends to the New Hampshire resident members of 123, LLC for purposes of the I&D tax.

RULINGS

Based on the facts represented by the Petitioners, and the regulatory provisions discussed above, the Department makes the following rulings:

1. The Petitioners have no BPT liability as a result of the conversion of ABC, Inc. from a New Hampshire business corporation to 123, LLC to a New Hampshire limited liability company, under the provisions of RSA 304-C:147 through 149.
2. The Petitioners have no BET liability as a result of the conversion of ABC, Inc. from a New Hampshire business corporation to 123, LLC to a New Hampshire limited liability company, under the provisions of RSA 304-C:147 through 149.
3. 123, LLC shall continue to file the required BPT and BET returns using:
 - a. The same FEIN that ABC, Inc. previously used;

- b. The same taxable period that ABC, Inc. previously used; and
 - c. The corporate business tax forms that ABC, Inc. previously used.
4. 123, LLC shall file a single business tax return for the calendar year covering the days before and the days after the statutory conversion.
 5. Any BET credits earned by ABC, Inc. and being carried forward at the time of the conversion shall be available for use by 123, LLC based on the original carry forward periods of the credits.
 6. The Petitioners have no RETT liability as a result of the conversion of ABC, Inc. to 123, LLC under the provisions of RSA 304-C:147 through 149.
 7. The statutory conversion of ABC, Inc. to 123, LLC under the provisions of RSA 304-C:147 through 149 shall not create dividend income to the shareholders of either ABC, Inc. or 123, LLC so long as the conversion qualifies as a tax-free corporate reorganization under IRC § 368(a)(1)(F).
 8. 123, LLC will have non-transferable membership interest and, accordingly, distributions from 123, LLC shall not be considered dividends to the New Hampshire resident members of 123, LLC for purposes of the I&D tax.
 9. 123, LLC will be considered a taxable entity under RSA 77:3, I(b) to the extent that it receives more than \$2,400 in interest and/or dividend income in any taxable period.

Date

John T. Beardmore, Commissioner