

New Hampshire Department of Revenue Administration
45 Chenell Drive, Concord, NH 03301

TECHNICAL INFORMATION RELEASE
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A Technical Information Release is designed to provide immediate information regarding tax laws administered by the Department or the policy positions of the Department as a service to taxpayers and practitioners. A Technical Information Release represents the position of the Department on the limited issues discussed herein based on current law and Department interpretation. For the current status of any tax law, practitioners and taxpayers should consult the source documents (i.e., Revised Statutes Annotated, Rules, Case Law, Session Laws, etc.). Questions should be directed to Customer Service at (603) 271-2191.

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Sales of Personal Versus Business Asset For Business Profits Tax Purposes

The *Business Profits Tax* (RSA 77-A) applies to the sale of assets that are being or have been used in the conduct of business activity in New Hampshire. The characterization of an asset as being a business asset is based upon the facts of the situation as applied within the context of New Hampshire tax law. The characterization of an asset under the federal income tax system does not necessarily dictate the treatment to be used under New Hampshire tax law.

The Department of Revenue Administration shall consider the sale of property incidentally rented to be the sale of personal residential property and not subject to the business profits tax under the following circumstances:

- (1) The rental property is a vacation home for the taxpayer and has been rented for 14 days or less in any one year prior to its sale; or
- (2) The property served as the principal residence of the taxpayer immediately before the incidental rental and it met the following criteria during the period of incidental rental:
 - (a) the property was being actively marketed for sale by the owner or real estate agent; and
 - (b) the taxpayer did not deduct for federal tax purposes any rental expenses such as, but not limited to, maintenance, depreciation or repairs that would not have been deductible as an itemized deduction for federal income tax purposes had the property continued to have been used as the taxpayer's principal residence.

In all other instances, it will be necessary for taxpayers or tax practitioners to analyze all of the facts and circumstances of a transaction to determine whether the sale was business related and subject to the *Business Profits Tax*.

In analyzing the facts and circumstances of the transaction, there are three important questions to be answered to determine the proper classification of the asset. The questions to be answered are as follows:

- (1) Could the asset sold ever be classified as a business asset within the context of the business profits tax law?

- (2) Was the asset used in any business activity?
- (3) Was the asset owned by a business organization?

As will be seen in the following paragraphs, questions 1, 2 and 3 are interrelated. A determination on question 2 is the pivotal point for the analysis. The gain or loss on the disposition of an asset would not be reportable for New Hampshire tax purposes unless business activity is or has been conducted by the party who owned the asset prior to its sale.

Determination of Business Asset

Since the sale of business assets are taxable under the *Business Profits Tax*, we must review all of the facts that are pertinent to determine whether or not the asset in question could have ever been classified as a business asset within the context of the *Business Profits Tax*. Business assets are defined in RSA 77-A:1, XI as "any tangible or intangible property, whether real or personal, previously used, currently used, or available for use in any business activity" (emphasis added). This definition is broad in nature and as can be seen, the character of the asset is not necessarily determined at the precise moment of the sale. Although a residence may have been used as a "personal residence" of the proprietor in prior years, this does not exempt the sale from state taxation. This is true even in instances where under the federal income tax system the gain could be deferred under Internal Revenue Code Section 1034. Under the federal tax system, it is possible to recognize no gain on the sale of residential property utilizing the provisions of Internal Revenue Code Section 1034 while at the same time renting the property and deducting the rental expenses.

The reverse of this situation would also be applicable. A residence that had been rented in past years and converted to the owner's personal residence might not be subject to the tax. As an example, the rental of a former personal residence at fair market value for a substantial period of time while waiting for the real estate market to improve would likely be subject to state tax. A temporary rental to someone at below market rates while the property is being marketed for sale in order to prevent vandalism would likely not be considered to be business activity.

Determination of Business Activity

If one concluded that the asset sold could be considered a business asset under the New Hampshire tax system, an analysis of what constitutes business activity must be undertaken. Business activity is defined under the *Business Profits Tax* (RSA 77-A:1, XII) as "a group of actions performed by a business organization for the purpose of earning income or profits from such actions and includes every operation which forms a part of, or a step in, the process of earning income or profits from such group of actions. The actions ordinarily include, but are not limited to, the receipt of money, property, or other items of value and the incurring or payment of expenses". This definition applies to a wide range of activities. The New Hampshire Legislature did not adopt the various Internal Revenue Code classifications of income or activities but rather chose to treat selected activities as business activities within the *Business Profits Tax*.

As an example, the rental of property was one of the activities the legislature classified as business activity. If residential real property is used by someone other than the owner for a minimum fee for a single day, it appears that such use could fall within the definition so long as there was a purpose of earning income or profits. In order to refine the application somewhat, there should be a review of the factual information to see if the property was rented at the fair market value; and, whether expenses such as, but not limited to, maintenance, depreciation, repairs, taxes and interest were deducted for federal or state tax purposes. The fact that an activity is not considered to be business activity under the Internal Revenue Code would not control since the *Business Profits Tax* is not an identical statute.

Determination of Business Organization

Assuming that there appeared to be some business activity, the next issue to be resolved is whether the activity was conducted by a business organization. Business organization is defined in the law (RSA 77-A:1, I) as "any enterprise, whether corporation, partnership, proprietorship, association, business trust, real estate trust or other form of organization, organized for gain or profit, carrying on any business activity within the state, except such enterprises as are expressly made exempt from income taxation under the United States Internal Revenue Code as defined in RSA 77-A:1, XX."

To provide further guidance in the area of individuals, it is necessary to review the definition of gross business profits for a proprietorship to determine what activities of the individual would be considered to be business in nature. The law indicates that the gross business profits of a proprietor should include "...the amount of net profit or loss from a business, profession, rental, or farming activities as would be determinable under the provisions of the United States Internal Revenue Code as defined in RSA 77-A:1, XX adjusted by the amount of any gains or losses from the sale of assets held or used in business activity" (emphasis added) The rental of residential or commercial property is considered business activity for New Hampshire tax purposes and the individual or entity conducting such activity falls within the statutory definition of a business organization.

Changes in Character of Assets

As can be seen from the preceding paragraphs, the character of an asset could in fact change over a period of time. In determining whether there has been a change in the character, a complete analysis of all the facts and circumstances must be undertaken to determine the substance of the transaction. The form of a transaction will not necessarily govern the taxability of the transaction. Changing the use or transferring the ownership of a business asset from a business organization to a related party at 11:59 PM on June 30 and the sale of that asset to another party at 12:01 AM on July 1 most certainly will not change the character of the asset transferred or sold. The New Hampshire Supreme Court in Johns-Manville Products Corporation v. Department of Revenue Administration 115 N.H. 428(1975), determined that the mere holding of land which had been acquired to provide timber for its manufacturing business did not convert it to investment property even though it was no longer being used in the manufacturing business. The sale of the land did produce profits subject to taxation.

Unfortunately, other than the criteria outlined in the second paragraph of this document, there is no "bright line" test that can be applied to determine the taxability of asset sales. Taxpayers or tax preparers must review and analyze all of the facts and determine the substance of a particular transaction before a proper characterization can be made.

Individuals who need auxiliary aids for effective communication in programs and services of the Department of Revenue Administration are invited to make their needs and preferences known to the N.H. Department of Revenue Administration, 45 Chenell Drive, Concord, NH 03301 or by contacting them at (603) 271-2318.