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IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

NEBRASKA ENERGY, L.L.C,)
)
 Petitioner,)
)
 vs.)
)
 MARY JANE EGR, Tax Commissioner)
 of the State of Nebraska, the)
 NEBRASKA DEPARTMENT OF)
 REVENUE, and STATE OF)
 NEBRASKA,)
)
 Respondents.)

CASE NO. CI02-301

ORDER

THIS MATTER came before the court for hearing on the merits of petitioner's appeal on April 28, 2003. Attorney William Kutilek appeared on behalf of the petitioner and Assistant Attorney General L. Jay Bartel was present on behalf of the respondents. Exhibits 1 and 2 were offered and received into evidence. The matter was argued and submitted on briefs. The court, being fully informed, now finds and orders as follows:

FACTS

Petitioner Nebraska Energy is a Kansas limited liability corporation with its principal office in Aurora, Nebraska. For tax years 1997, 1998, and 1999, the petitioner was eligible to receive credits pursuant to the Nebraska Employment and Investment Growth Act. Neb. Rev. Stat. §§ 77-4101 to 77-4113 (1996 and Cum. Supp. 2002). Said Act was created "to make revisions in Nebraska's tax structure in order to encourage new businesses to relocate to Nebraska, retain existing businesses and aid in their expansion, promote the creation and retention of new jobs in Nebraska, and attract and retain investment capital in the State of Nebraska." Neb. Rev. Stat. § 77-4102(2). Once eligibility is established, the Act generally

allows taxpayers to obtain tax incentives through the attainment of certain levels of capital investment and employment expansion. The tax incentives are generally in the form of tax credits and tax refunds.

On or about September 30, 1998, the petitioner filed its Nebraska Partnership Return of Income, Form 1065N, for the 1997 tax year. (T3-6). In addition to filing its Form 1065N return, the petitioner also filed Form 775N, Nebraska Employment and Investment Growth Act Credit Computations Form per Neb. Rev. Stat. § 77-4106. (T7-9). On its original Form 775N for tax year 1997, the petitioner calculated \$111,194.00 of available tax credits for the year, the entire amount of which was distributed to the members of Nebraska Energy. (T7, Lines 11 and 17, Column 4 (Fourth Year 1997), and T9).

On or about September 22, 1999, the petitioner filed Form 1065N for the 1998 tax year and attached Form 775N with its 1998 return. (T39-45). Form 775N for 1998 showed a corrected credit computation for tax year 1997 in the amount of \$841,084.00. (T43, Line 11, Column 4 (Fourth Year 1997)). The amount of credit shown on the 1997 return was \$111,194.00. (T7, Line 11, Column 4 (Fourth Year 1997)). Form 775N accompanying the petitioner's 1998 return showed the entire amount of the corrected credit computation for tax year 1997 (\$841,084.00) was distributed to the members of Nebraska Energy. (T43, Line 17, Column 4 (Fourth Year 1997)). Form 775N for tax year 1998 also listed total allowable credit for the current year (1998) as \$236,236.00, all of which was distributed to the members of Nebraska Energy. (T44, Line 11 and 17, Column 1 (Fifth Year 1998) and T45).

On or about September 27, 2000, the petitioner filed its Nebraska Partnership Return of Income, Form 1065N, for the 1999 tax year and attached Form 775N with its 1999 return (T75-

81). Form 775N again reflected total allowable credit for the year 1997 in the amount of \$841,084.00, all of which was distributed to its members. (T79, Lines 11 and 17, Column 4 (Fourth Year 1997)). Form 775N accompanying the 1999 return also listed the total allowable credit for the year 1998 tax year as \$236,236.00, all of which was distributed to the petitioner's members. (T80, Lines 11 and 17, Column 1 (Fifth Year 1998)). For the 1999 tax year, Form 775N listed \$77,135.00 as the total allowable credit, all of which was also distributed to the members of Nebraska Energy. (T80, Lines 11 and 17, Column 2, Sixth Year 1999)).

On or about July 2, 2001, the petitioner filed amended Forms 1065N and 775N for the 1997, 1998, and 1999 tax years. (T10-13 (1997); T46-49 (1998); and T82-85 (1999)). Nebraska Energy argues that its ability to amend said returns is pursuant to Neb. Rev. Stat. § 77-2775(2).

This statute states:

Whenever the amount of a taxpayer's income which is taxable in any state for any taxable year or any tax credits allowable in such state are changed or corrected in a way material to the tax liability owed to this state by the agency having the authority to examine returns filed with such state or any other competent authority or whenever an amended return is filed by any taxpayer with a change or correction material to the tax liability owed to this state with another state, such change or correction shall be reported to the Tax Commissioner within 90 days after the final change or correction or filing of the amended return.

Neb. Rev. Stat. § 77-2775(2). The content of all three amended Forms 1065N were identical to the content in the original forms filed by the petitioner for each of these years. (T3-6 and T10-13 (1997); T39-42 and T46-49 (1998); and T75-78 and T82-85 (1999)). The petitioner also filed an amended Form 775N credit computations with each return. (T14-17 (1997); T50-53 (1998); and T86-89 (1999)).

The amendment the petitioner made in all three returns concerned Form 775N and the distribution of the allowable tax credits for each of the three years to members of Nebraska Energy. While the original returns showed a distribution of all allowable tax credits for said year to the petitioner's members, the amended returns made no such showing. For each of the three years, the amended Forms 775N portrayed that no distribution had been made to the members of Nebraska Energy. (T14, Line 17 (1997); T50-51, Line 17 (1998); and T86-87, Line 17 (1999)).

By letter dated October 25, 2001, the Tax Commissioner advised the petitioner of her decision to disapprove the amended tax returns for the years 1997, 1998 and 1999 for the reason that the amendments have the effect of transferring Nebraska Employment and Investment Growth Act tax credits from the members of Nebraska Energy to Nebraska Energy. (T112-113). The Commissioner noted that although the amended returns were timely filed, Neb. Rev. Stat. § 77-4108 (Cum. Supp. 2002) provided limited situations in which Employment and Growth Act credits were transferable, and the statute "provide[d] an exclusive list of the allowable ways of transferring credits." (T112). Section § 77-4108 states as follows:

- (1) The incentives allowed under the Employment and Investment Growth Act shall not be transferable except in the following situations:
 - (a) Any credit allowable to a partnership, a limited liability company, a subchapter S corporation, or an estate or trust may be distributed to the partners, members, shareholders, or beneficiaries in the same manner as income is distributed for use against their income tax liabilities, and such partners, members, shareholders, or beneficiaries, shall be deemed to have made an underpayment of their income taxes for any recapture required by section 77-4101

The Commissioner determined that, while subsection (1)(a) of § 77-4108 "allow[ed] the distribution of credits to the members that was elected on Nebraska Energy's original filings for

1997 through 1999. . .,” the statute “did not provide a method for the credits to be transferred back from the members of the limited liability company to the petitioner.” (T112). The Commissioner therefore “disapprov[ed] the change in distribution requested in the amended partnership returns for 1997 through 1999” (T112).

The petitioner asked the Commissioner to reconsider her rejection of the amended returns by letter dated January 16, 2002. (T116). The petitioner also provided statements signed by officers of each member of Nebraska Energy titled “Consent to Amendment of Nebraska Form 775N,” stating the member “had no objections to, and in fact, support[ed]” Nebraska Energy’s efforts to amend its Forms 775N “to reflect the return to [the petitioner’s] account of Nebraska Employment and Investment Growth Act Credits that [had] not been used by the member.” (T117-119). The Commissioner denied Nebraska Energy’s request for reconsideration by letter dated January 18, 2002. (T120). The Commissioner reiterated her position that the Employment and Investment Growth Act “limit[ed] transfers of credits to those specified in the Act, and the transfer of credits from a member of an LLC to the LLC is not one of the types of transfers listed.” (T120). With regard to the consent forms provided by Nebraska Energy, the Commissioner noted “the agreement of the parties to transfer the credits is immaterial when the statute . . . prohibits such transfers.” (T120). The petitioner filed its appeal to this court on January 22, 2002.

The parties have stipulated that, in the event the court determines the Tax Commissioner erred in refusing to accept Nebraska Energy’s amended filings for 1997 through 1999, the total amount of tax credits available to the petitioner under the Employment and Investment Growth Act would be \$1,181,456.00. (Joint Stipulation, ¶ 9). Any such credits would be subject to

adjustment by audit and available for use during any open periods and could be carried forward, if unused, through the end of the Carryover Period, which is currently projected to be 2009. (Joint Stipulation, ¶ 9).

STANDARD OF REVIEW

Any person aggrieved by a final decision in a contested case, whether such decision is affirmative or negative in form, shall be entitled to judicial review under the Administrative Procedures Act. Neb. Rev. Stat. § 84-901, et seq; Neb. Rev. Stat. § 84-917(1)(Reissue 1999). Accordingly, review is conducted by the court without a jury de novo on the record of the agency. Neb. Rev. Stat. § 84-917(5)(a) (Reissue 1999).

DISCUSSION

Nebraska Energy has petitioned this court for a review of the agency decision and an order vacating the respondents' disapproval and denial of the amended income tax returns for the tax years 1997, 1998 and 1999. For the reasons stated below, the court affirms the decision of the Tax Commissioner and the Nebraska Department of Revenue (NDOR).

The petitioner argues that pursuant to Neb. Rev. Stat. §77-2775 (Cum. Supp. 2002), Nebraska Energy has the authority to amend its tax returns for the years 1997, 1998 and 1999. The court agrees that said statute provides authority to amend tax returns; however, the court agrees with the respondents and believes that what the petitioner is trying to do by "amending" its returns is actually transferring the tax credits previously distributed to the members of Nebraska Energy back to Nebraska Energy. Neb. Rev. Stat. § 77-4108 restricts the transfer of tax credits to certain situations, one of which is the transfer of tax credits from a limited liability company to the members of the limited liability company. The statute, however, does not

authorize transfers from the members of the company to the company. Nebraska Energy made a voluntary election under § 77-4108 to distribute its credits to its members. Section 77-4108 allowed this choice, but also put the petitioner on notice, that once the transfer had been made, it could not be undone.

In *Marmula v. Commissioner*, 346 F.2d 1016 (9 Cir. 1965), the question was whether a taxpayer, who improperly used the "deferred basis" method to report profit from certain real estate sales transactions, could subsequently elect to report the income under the installment method. *Id.* at 1017. The Commissioner denied the taxpayer permission to use the installment method, and issued a deficiency including the entire profit as taxable in the year of sale. *Id.* The Tax Court affirmed, concluding the taxpayer's "attempt to report on the deferred-payment method resulted in a binding election which precluded him from subsequently reaping the benefits of the installment method. *Id.* at 1018. On appeal, the Ninth Circuit reversed. The court recognized, however, that a number of decisions prohibiting conversion to the installment method, including *Pacific National Co. v. Welch*, 304 U.S. 191 (1938), "always involved situations in which the taxpayer had initially elected a valid alternative method of reporting income." *Marmula*, 346 F.2d at 1018. The *Marmula* Court stated that "the taxpayer [in *Pacific National Co.*] elected the deferred payment method in an appropriate situation, where it clearly and properly reflected his income. He later was denied the right to recalculate his tax liability with the installment method. Either method could have been used; petitioner made his choice, and he and the Commissioner were bound by it." *Id.*

The court in *Marmula* agreed with the result in *Pacific National Co.* based on the facts present in that case. The Ninth Circuit stated, "Once a taxpayer makes an election of one of two

or more alternative methods of reporting income, he should not be permitted to convert, of his own volition, when it later becomes evident that he has not chosen the most advantageous method." *Marmula* 346 F.2d at 1018. The *Marmula* Court found, however, that the present case

did not involve an election by a taxpayer to which he [was] conclusively bound. Indeed, the taxpayer could not be bound by his election for it was a non-allowable choice - it was not allowable and not allowed. No one was bound. We are not here concerned with a taxpayer who uses hindsight to learn that the method he had chosen, though proper, was not the most advantageous to him. We are rather concerned with an instance where the method chosen by the taxpayer is advanced in good faith, and later conceded to have been improper.

Id. at 1018-19. The court in *Marmula* recognized the taxpayer did not seek to undo a permissible choice in reporting its income. The initial election made by the taxpayer was improper, and therefore, could not be binding. The Ninth Circuit thus distinguished *Pacific National Co.* and reversed the Tax Court, directing that the taxpayer be allowed to recalculate his tax liability using the installment method of income recognition for the real property sales transactions. *Id.* at 1019.

While not exactly on point, this court feels that both the *Marmula* and *Pacific National Co.* cases are helpful in discussing the case at bar. Nebraska Energy, unlike the taxpayer in *Marmula*, did not make an invalid election when it chose to distribute its allowable tax credits to its members for the years 1997 through 1999. The petitioner appears to be in a situation quite similar to the taxpayer in *Pacific National Co.*, who elected a valid means to report income for tax purposes and later desired to change that election. The petitioner voluntarily elected to distribute the tax credits to its members pursuant to Neb. Rev. Stat. § 77-4108 and once that election was made, the statute does not provide a method for which the credits can be transferred back. Furthermore, the court does not believe that the decision of the Commissioner denies the petitioner of tax credits it is legally entitled to receive. The credits were distributed to the

members of Nebraska Energy and no longer belong to the petitioner. The credits are still available to the members and can be used by them to reduce their own income tax liabilities or to receive refunds of taxes previously paid.

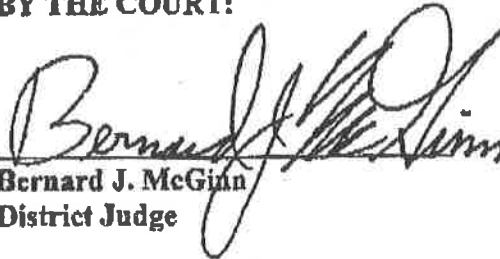
The petitioner also argues that even if the court finds that the basis for the respondents' decision is sound, the additional tax credits in the amount of \$729,890.00 reported by the petitioner on its 1997 amended return cannot be disapproved. Furthermore, the petitioner claims that at most, the basis of the respondents' decision can effect only those tax credits reported on Line 17 of the petitioner's original tax returns. The court disagrees.

The court finds there is sufficient evidence in the record to support the finding that \$729,890.00 in additional tax credits the petitioner claimed for the 1997 tax year were also distributed to the members of Nebraska Energy. On the petitioner's 1998 original Form 775N, Line 11, the corrected amount of total allowable credit for 1997 was \$841,084.00. Subtracting the total allowable credit of \$114,194.00 on Nebraska Energy's original Form 775N for 1997, all of which was shown as distributed to the members (T7, Line 17, Column 4, (Fourth Year 1997)), from the corrected credit amount of \$841,084.00, leaves a total additional credit reported on the petitioner's original Form 775N of \$729,890.00. Distribution of this corrected credit of \$841,084.00 for 1997 was shown on both the 1998 and 1999 original Form 775N. (T43, Line 17, Column 4 (Fourth Year 1997); T79, Line 17, Column 4 (Fourth Year 1997)). The court believes the record supports the finding that the additional amount of \$729,890.00, which the petitioner claims in tax credits for the year 1997, was distributed to the members of Nebraska Energy.

IT IS ORDERED, that for the reasons set forth above, the Commissioner's decision to reject the petitioner's amended income tax returns for the 1997, 1998 and 1999 tax years is affirmed. Costs of this action are to be paid by the respondents.

DATED this 2nd day of July, 2003..

BY THE COURT:


Bernard J. McGinn
District Judge

cc: *William R Kutilek, Attorney for Petitioner*
L. Jay Bartel, Assistant Attorney General, Attorney for Respondents