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Recent Developments: Comptroller of the Treasury Income Tax Division v. American Satellite Corporation: Out-of-State Losses Suffered by Multi-State Corporation May Be Used to Offset in-State Capital Gains for Tax Purposes

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will be recognized, when they result from the sexual transmission of a dangerous, contagious and incurable disease. However, the plaintiff must make the requisite factual showing of each element in every case.

—Jonathan S. Beiser

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Comptroller Of The Treasury Income Tax Division v. American Satellite Corporation: OUT-OF-STATE LOSSES SUFFERED BY MULTI-STATE CORPORATION MAY BE USED TO OFFSET IN-STATE CAPITAL GAINS FOR TAX PURPOSES

In *Comptroller Of The Treasury Income Tax Division v. American Satellite Corporation*, 312 Md. 537, 540 A.2d 1146 (1988), the Court of Appeals of Maryland held that out-of-state losses, suffered by a multi-state corporation reporting no federal taxable income, may offset in-state capital gains allocable to Maryland under Md. Ann. Code art. 81 § 316(b)(3) (1957, 1980 Repl. Vol.). The court of appeals determined that a corporation must have a "net income" as defined in Md. Ann. Code art. 81, § 280A(a) (1957, 1980 Repl. Vol.) before § 316(b) comes into play.

Section 280A(a) provides that the "net income" of a corporation is its taxable income as defined in the laws of the United States, thus equivalent to its federal taxable income. Sections 280A(b) and (c) provide items which are added to, or subtracted from, a corporation's federal taxable income to determine its final "net income." Section 316(b) provides the means of allocating the "net income" of multi-state corporations between Maryland and other states where the corporation does business.

The Comptroller of the Treasury made an assessment of \$252,786.36 against American Satellite Corporation (ASC) for a claimed deficiency from a \$5,000,000 intangible capital gain that ASC realized in 1982. This gain was allocable to Maryland under § 316(b)(3), which provided that a corporation's capital gains and losses from sales of intangible personal property were allocable to Maryland if the corporation had its domicile in Maryland. At the time of the Comptroller's assessment in 1982, ASC's domicile was Maryland (this situs allocation provision of 316(a) and (b) was repealed in 1984).

In 1982, ASC filed a consolidated federal tax return with Fairchild Industries, its parent company. If ASC had filed a separate tax return, as required by Md. Ann. Code art. 81, § 295, its federal taxable income for 1982 would have been \$1,437,808. However, ASC had net operating losses carried over from previous years that amounted to \$51,687,594. These net operating losses completely offset ASC's federal taxable income for 1982, thus reducing its income to zero. Consequently, ASC asserted that it had no "net income" under § 280A(a) and showed no taxable income on its Maryland return.

Later, ASC acknowledged that it did owe \$14,229 as Maryland taxable income for state and local income taxes as required by § 280A(b), and for personal property taxes as required by Md. Ann. Code art. 81, § 288(g) (1957, 1980 Repl. Vol.).

The Comptroller, however, determined that ASC owed \$252,786.36 in taxes. He arrived at this number by apportioning ASC's net operating losses to only \$1,297,452, instead of the \$51,687,594 that ASC claimed. The Comptroller arrived at the smaller number by making the following calculations: (1) he took the \$14,229 (zero federal taxable income plus the § 280A(b) and § 288(g) modifications); (2) he subtracted the \$5,000,000 capital gain, subject to 100% situs allocation under § 316(b)(3), from the \$14,229 (allocable items are 100% taxable to Maryland and should not be apportioned); (3) this resulted in \$-4,985,771; (4) he multiplied this number by the three-factor apportionment fraction of .260231 (this comes from a formula which takes into account property, payroll and sales, which are operations subject to apportionment) under § 316(c), which equalled \$-1,297,452; (5) then he added back the \$5,000,000 allocated capital gain not subject to apportionment; (6) which left \$3,702,548 as Maryland taxable income; (7) which was multiplied by the 7% tax rate provided for under § 288; (8) which totalled \$259,178.36; (9) from which \$6,392.00 was subtracted as governed by § 288(g); this left a final tax owed of \$252,786.36.

The Comptroller's view was that § 316(b)(3) worked in the same manner as § 280A(b) and (c), that is, to modify the federal taxable base. He supported his position by arguing that when the statute is read as a whole, the words "[E]xcept as hereinafter modified" from § 280A(a), included the provisions of § 316(b)(3) as additions to taxable base. Thus, the Comptroller's position was that capital gains were allocable to Maryland under § 316(b)(3) if the taxpayer's domicile was Maryland. Since out-of-state profits were not taxable in Maryland, the Comptroller felt that out-of-state losses should not be used to offset Maryland capital gains. Therefore, he determined that even though ASC had no "net income" for federal tax purposes, ASC's capital gain would be subject to Maryland income tax.

On April 16, 1986, the Maryland Tax Court ordered the assessment of the Comptroller to be reversed. The tax court felt that § 316 modifications arise only "when a corporation has net income as defined under § 280A." *Comptroller Of The Treasury Income Tax Division v. American Satellite Corporation*, ___ Md. ___,

—A.2d— (1988). Section 316(b) cannot be used as a separate basis for imposing tax if there is no federal taxable income to begin with. *Id.* The Circuit Court for Baltimore City affirmed the Tax Court and held that *Ford Motor Land Dev. v. Comptroller*, 68 Md. App. 342, 511 A.2d 578, cert. denied, 307 Md. 596, 516 A.2d 567 (1986) was controlling.

Ford Motor involved a Delaware corporation involved in real estate development and related activities in Maryland. Ford sold real property, that it owned in Maryland, in 1978 and realized a net capital gain of close to \$3,000,000 from the sale. However, between 1973 and 1978, Ford suffered overall net operating losses which exceeded, and offset, the 1978 capital gain. Ford realized this after it had already submitted its 1978 taxes and consequently asked for a refund, claiming it had no "net income" to be taxed in Maryland.

The Comptroller, on the other hand, assessed additional taxes on Ford arguing that Ford's capital gain was Maryland net income, and therefore taxable by Maryland under § 316(b) regardless of Ford's net operating losses. The Maryland Tax Court agreed with the Comptroller and affirmed his assessment. The Circuit Court for Baltimore City affirmed the tax court. On appeal, the Court of Special Appeals of Maryland reversed, basing their decision on statutory construction.

The court of special appeals held that a corporation must have a "net income" under § 280A(a) before the capital gains allocation provision of § 316(b) can apply. The court determined that the plain meaning of "net income" for a corporation was its federal taxable income as governed by § 280A. *Comptroller Of The Treasury Income Tax Division v. American Satellite Corporation*, 312 Md. 543-44, 540 A.2d at 1149 (1988) (citing *Ford Motor*, 68 Md. App. at 350-351). Since § 316 provides the means of allocating "net income" between Maryland and other states, the existence of a "net income" is required as a prerequisite to using § 316. *Id.*

In *American Satellite Corporation*, the Court of Appeals of Maryland used a statutory construction analysis, as did the court of special appeals in *Ford Motor*, to determine that the meaning of "net income" was federal taxable income. *American Satellite Corporation*, 312 Md. at 544-45, 540 A.2d at 1150. The court of appeals decided that the appropriate method to reach the definition of "net income" was to ascertain the legislature's intent in enacting the various statutes in question. *Id.* at 544, 540 A.2d at 1150. With this problem solved, the court could then determine whether § 316 modifications could

be made even if a corporation reported no "net income for the year in question." *Id.*

The court of appeals used the legislative committee reports to ascertain the legislative intent of the statutes in question. The committee reports clearly demonstrated that the purpose of the current tax law, which was enacted in 1967, was to significantly restructure the earlier tax law and bring it into conformity with the federal tax scheme. *Id.* at 539, 540, A.2d at 1141. As was said previously, the court of appeals also determined that the legislative intent was for the "net income" of a corporation to be its federal taxable income plus or minus certain modifications. See *American Satellite*, 312 Md. at 545, 540 A.2d at 1150 (citing Technical Supplement to the 1975 Report of the State Tax Reform Study Committee (Legislative Council Of Maryland at 145 (Feb. 1976))). These modifications were to be specific additions and/or subtractions to the federal taxable income. The result of these additions and/or subtractions would be the corporation's "net income." The modifications which were listed in the committee report corresponded exactly to those modifications listed in §§ 280A(b) and (c). See *Id.* There was no indication in the committee report that the Comptroller's position, namely that § 316 modifications should be used when a corporation reported no "net income," was correct. See *American Satellite*, 312 Md. at 545-46, 540 A.2d at 1150.

Therefore, the Comptroller was incorrect in trying to read into the provisions of § 280A(b) a further addition to the taxable base from § 316(b)(3). *Id.* at 546, 540 A.2d at 1150-51. Consequently, § 316(b) cannot be used unless a corporation has a "net income" as defined under the laws of the United States because there must be something to allocate in the first place. *Id.* at 547, 540 A.2d at 1151. Hence, ASC only owed \$14,229 in taxes as required by § 280A(b) for state and local income taxes, and § 288(g) for personal property taxes.

In *American Satellite*, the Court of Appeals of Maryland concluded that the "net income" of a corporation is its federal taxable income as modified by the addition and/or subtraction of those items listed in § 280A(b) and (c). Furthermore, the court determined that if a corporation has no taxable income because its in-state capital gains were offset by out-of-state losses, then § 316 modifications cannot be used to assess further additions. Therefore, § 316 modifications can only be used when a corporation has a "net income."

—Richard M. Goldberg

United States v. Whitehead: RAILWAY PASSENGER'S FOURTH AMENDMENT RIGHTS NOT VIOLATED BY CANINE SNIFF OF LUGGAGE BASED ON REASONABLE SUSPICION

In the consolidated appeal of *United States v. Whitehead*, 849 F.2d 849 (4th Cir. 1988), the United States Court of Appeals for the Fourth Circuit held that the expectation of privacy of one travelling by railroad is substantially less than that of a person occupying a temporary residence, such as a hotel room. In addition, the court held that the brief exposure of the interior of a sleeping compartment on board a train to narcotics detection dogs is constitutionally permissible when based on an articulable, reasonable suspicion that the contraband is contained within the occupant's luggage. In so holding, the court affirmed the district court's ruling.

On November 26, 1986, ten minutes before the departure of the morning train from Miami to New York City, two special narcotics officers assigned to the Miami station observed the defendant, Whitehead, arrive at the station in a taxi. As he emerged from the cab, Whitehead carefully surveyed the station before entering. Then, carrying a sports bag and a suitcase, he entered the station, where he paid \$403 in cash for a one-way, first-class sleeping car ticket to New York.

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