

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

IN THE MATTER OF)	
HOPS STATIONARY, INC.)	OAH Case No. 14-1315-TAX
)	
Corporate Income Net Tax)	
<u>Tax Year Ending June 30, 2013</u>)	

DECISION

I. Introduction

This case is the tax appeal of Hops Stationary, Inc., (Hops). Hops is appealing the DOR’s informal conference decision issued on July 9, 2014. In this decision, DOR determined that Hops had not made a valid election to waive its ability to carry back a net operating loss on its 2004 Alaska corporate income tax return. Because this election was not valid, Hops could not carry this loss forward on its return for the tax year ending on June 30, 2013. This resulted in an assessment of additional tax of \$919 plus interest for that tax year.

CPA, Andy Warwick represented Hops. Mary Hunter Gramling, Assistant Attorney General, represented the Alaska Department of Revenue (DOR). The parties filed briefing. The record closed on October 30, 2014.

Based on the undisputed facts, DOR correctly assessed the additional taxes and interest. Hops attempt to elect to carry the loss forward was not effective because, “carry loss forward,” the language Hops used in its attempt to make this election, did not indicate the IRC section that was being relied on to make the election.

II. Undisputed Facts

Hops filed a 2004 Alaska corporate income tax return showing a net operating loss of \$9,770 for that tax year. Years later, Hops timely filed an Alaska corporate income tax return for the tax-year ending June 30, 2013. On this 2013 return, Hops included a deduction for this 2004 \$9,770 net operating loss (NOL). Hops’s position was that the deduction for the 2004 claimed loss could be carried forward to 2013 because Hops had indicated its intent to carry this loss forward on the 2004 return. DOR determined that this 2013 deduction could not be allowed because Hops had not made a sufficient election to forgo its right to carryback that net operating loss in 2004.

DOR no longer has the Hops 2004 Alaska corporate income tax return that was filed, because the Hops’s original 2004 Alaska tax return was destroyed in accordance with DOR’s

records retention schedule. Hops has provided an unsigned copy of that return. That copy includes the hand written notation: “carry loss forward” on line 3.

Mr. Warwick has explained why he decided to indicate Hops’s intent to waive a carry-back of this loss with this simple notation on the 2004 Alaska tax return. Mr. Warwick explained that Hops did not have a net operating loss to claim on its federal tax return for period covered by the 2004 Alaska tax return. Because there was no loss to claim on Hops’s 2004 federal tax return, Hops could not follow the normal process to indicate its intent to carry the net operating loss for both Alaska and the IRS. This process would be to simply check the appropriate box on IRS form 1120. This is the portion of the federal tax return that would be used to make the NOL carryforward election if the deduction was applicable to both Hops’s Alaska and federal tax liabilities. The Alaska 2004 tax return form did not include a similar check-box to waive carry-back for this net operating loss.

Unsure how to make a NOL carryforward election for Hops on the 2004 Alaska return, Mr. Warwick contacted DOR and was only told to make it clear on the Alaska return that Hops was carrying the loss forward. Mr. Warwick explained he believed at the time that he was following that advice when he added the hand written notation: “carry loss forward” on line 3 of Hops’s 2004 Alaska return.

Hops does not contest DOR’s calculations of the amount of tax due, if DOR’s legal position is correct. DOR does not dispute the accuracy of the copy of Hops’s 2004 tax return with the hand written notation “carry loss forward” on line 3 of Schedule A-SF.¹ The only dispute in this case is whether the notation on Hops’s 2004 tax return met the requirements to be an effective waiver to carry-back its net operating loss, which would have allowed the net operating loss to be carried forward and deducted on the 2013 return.

III. Discussion

a. Election to Carry Forward a NOL Deduction

Under the Federal Internal Revenue Code (IRC), Section 172(b)(3)(C) provides that in order to “carry forward” a net operating loss to offset income of a subsequent tax year without first “carrying back” that loss to the three prior tax years, a taxpayer must make an “irrevocable” election to that effect by the due date, including extensions of time, for filing the taxpayer’s

¹ Hops’s copy of it Alaska Corporation Net Income Tax Return Short Form for the tax year ending June 30, 2004 is found at Attachment A to Hops’s letter dated August 27, 2014.

return for the taxable year of the net operating loss.² The excerpt below is summary of federal case law on attempts to carry forward a net operating loss from a 1999 Tax Court Memorandum Opinion.³

Several cases have considered the effectiveness of taxpayers' elections to waive NOL carrybacks. It has been held that the essence of section 172(b)(3)(C) is that a "taxpayer unequivocally communicates his election and binds himself to his decision concerning the best use of his net operating loss." *Young v. Commissioner*, 783 F.2d 1201, 1206 (5th Cir.1986). Elections made in compliance with the regulatory procedures or requirements have been held to be binding. In *Santi v. Commissioner, T.C. Memo.1990-137*, it was held that the following statement was sufficient to waive the carryback and permit the carryover of the taxpayer's NOL deduction: "Taxpayer elects to carry net operating loss over under I.R.C. 172(b)(2)(C)." In that case, even though the taxpayer's statement identified the wrong portion of section 172, the Court interpreted the statement in the context of the entire return and held that the waiver was valid. Likewise, in *Carlstedt Associates, Inc., v. Commissioner, T.C. Memo.1989-27*, the following statement was found to be unequivocal and a binding election: "IN ACCORDANCE WITH CODE SECTION 172(b) TAXPAYER HEREBY ELECTS TO RELINQUISH THE ENTIRE CARRYBACK PERIOD WITH RESPECT TO THE CURRENT NET OPERATING LOSS." In *Powers v. Commissioner*, 43 F.3d 172 (5th Cir.1995), affg. in part, revg. in part and remanding 100 T.C. 457 (1993), however, the Court of Appeals for the Fifth Circuit held that referencing a Code section other than section 172 served to make a taxpayer's election ineffective. In *Powers*, the taxpayer referenced section 56(b)(3)(C), and no reference was made to section 172. The Court of Appeals for the Fifth Circuit observed in *Powers* that *Santi v. Commissioner*, supra, was distinguishable because the taxpayer there referred to section 172. See *Powers v. Commissioner*, supra at 178 n.7.

As can be seen by the excerpt above, while the essence of an effective carryforward election is an unequivocal communication and commitment by the taxpayer, there are some specific requirements imposed by regulation, and the court interpretations of those regulations, on the form that election must take in order to effectively elect to carry a net operating loss forward. Section 172(b)(3)(C) of the Internal Revenue Code requires that a taxpayer make an election carry a net loss forward as set out in regulation and that the election must be irrevocable. The pertinent regulation requires that the election indicate the section under which the election is being made and shall set forth information to identify the election, the period for which it applies, and the taxpayer's basis or entitlement for making the election.⁴

² *Young v. C.I.R.*, 783 F.2d 1201, 1202 (5th Cir. 1986).

³ *Harding v. C.I.R.*, 78 T.C.M. (CCH) 808 (T.C. 1999).

⁴ The Treasury Regulation setting out the requirements for making an election are found at Section 301.9100-12T(d).

Taxpayer's Position

Hops argues that DOR acted unreasonably and in a manner that is inconsistent with the requirements of I.R.C. 172(b)(2). Hops argues that the hand-written language on Hops's 2004 Alaska tax return, "carry loss forward," irrevocably precluded Hops from reversing course and carrying back the loss claimed on that return.

Hops argues that the legal test is whether the election to carry the loss forward was irrevocable and Hops's election passes this test. Hops's position is that the case law on valid elections focuses on whether or not the taxpayer's election was so unambiguously articulated that the election committed the taxpayer to a carry forward. Hops argues that, other than including the word "elects" in the handwritten notation on Hops's 2004 Alaska tax return, Hops's declaration is essentially the same as the taxpayer's in *Power's*.

Standard of Review

AS 43.05.435(2) & (3) establish the applicable standards of review requiring the administrative law judge to resolve a question of law through the exercise of the independent judgment of the administrative law judge, and only to defer to DOR in a matter where DOR has exercised legally vested discretion and DOR's exercise of that discretion had a reasonable basis. DOR has not requested deference on the basis of an exercise of discretionary authority.

Election to carry NOL Forward must include IRC Section Reference

Hops's interpretation of the holdings in the *Powers* case is not correct. The Court in that case distinguished two requirements of an effective carryforward election, one that could be inferred from the language of the taxpayer's election communication and one could not.

The requirement that a taxpayer's election to carry a loss forward must irrevocably waive the taxpayer's right to carry the loss back does not create a requirement that the taxpayer explicitly waive the right to carry the loss back. As Hops points out, the court rejected the argument that the election language, which did not explicitly waive the right to carry net operating loss back, still met the requirements of a carryforward election because the intent to waive the right to carry the loss back could be inferred from a declaration of the intent to carry the loss forward. The court noted that electing to carry a loss forward legally disqualifies a taxpayer from carrying that loss back. In relying on the part of the *Powers* decision that holds that this lack of this explicit language does not invalidate a carryforward election, Hops fails to recognize the significance of the lack of a regulatory requirement for an explicit waiver. The regulation does not require an explicit declaration of the taxpayer's intent to waive the right to carry the loss back.

The regulation does explicitly require that the election statement include language that “indicates the section under which the election is being made.” The language of Hops’s election did not include any indication of the IRC section being relied on. There was no reference in Hops’s the statement to any section of the code. The *Powers* court held that the requirement that the election statement not only include such a reference but that the reference must be correct. In response to the argument that the taxpayer’s reference to the wrong section of the IRC in the language of the attempted carryforward election the *Powers* court wrote:

We hold that the statements attached to Powers' 1978 and 1979 returns cannot be construed as elections to relinquish the carryback period under § 172 because they do not cite § 172, as the regulations require. The IRS's argument that we should look beyond the erroneous citation to § 56 and instead infer a valid § 172 election flies in the face of the temporary regulation⁵

Strict adherence to the regulatory requirement that a taxpayer indicate the IRC section relied on in making an election to carryforward the loss may seem to be putting form over substance. This is the focus Hops’s argument in this appeal. Adhering to regulatory requirements for making an election is an aspect of form that is often important in tax law, as demonstrated in the present case. Hop’s notes that in *Powers* it was the taxpayer arguing that the election was not valid, after having determined in hindsight, not available at the time of the election to carryforward, that the economics favored a carry back. The consideration that either the taxing authority or the taxpayer may be motivated to challenge a carryforward election demonstrates the importance of having requirements for the form a carryforward election must take set out in regulation and requiring strict adherence to those requirements. The consideration that this an irrevocable election, which a taxpayer may come to regret, explains the basis for the regulation establishing minimum requirements in the form of a valid election as well as the courts strict application of those requirements.

IV. Conclusion

DOR’s Informal Conference Decision issued on July 9, 2014 is affirmed.

DATED this 16th day of December, 2014.

By: Signed
Mark T. Handley
Administrative Law Judge

⁵ *Powers v. C.I.R.*, 43 F.3d 172, 179 (5th Cir. 1995).

NOTICE

1. This is the hearing decision of the Administrative Law Judge under Alaska Statute 43.05.465(a). Unless reconsideration is ordered, this decision will become the final administrative decision 60 days from the date of service of this decision.⁶
2. A party may request reconsideration in accordance with Alaska Statute 43.05.465(b) within 30 days of the date of service of this decision.
3. When the decision becomes final, the decision and the record in this appeal become public records unless the Administrative Law Judge has issued a protective order requiring that specified parts of the record be kept confidential.⁷
4. A party may file a motion for a protective order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.⁸
5. Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date of this decision becomes final.⁹

[This document has been modified to conform to the technical standards for publication.]

⁶ AS 43.05.465(f)(1).

⁷ AS 43.05.470.

⁸ AS 43.05.470(b).

⁹ AS 43.05.465 sets out the timelines for when this decision will become final.