STATE OF MAINE
SAGADAHOC, ss.

BUSINESS AND CONSUMER DOCKET
Location: West Bath
Docket No. BCD-WB-AP-09-09

E.I. DUPONT DE NEMOURS & CO.,

Petitioner

v.

STATE TAX ASSESSOR,

Respondent

ORDER ON REMAINDER OF
PETITONER'S MOTION FOR
PARTIAL SUMMARY JUDGMENT

Before the court is the remainder of the motion of Petitioner E.I. DuPont ("DuPont") for partial summary judgment on Count I of its amended 80C petition. The central issue is whether adjustments by Respondent State Tax Assessor ("Assessor") to DuPont's Maine corporate income tax returns for the 1999 and 2000 tax years are barred by the 3–year statute of limitations provisions of 36 M.R.S. § 141, as amended in 2003.[1]

PROCEDURAL POSTURE

DuPont originally moved for partial summary judgment on two, alternative grounds. First, DuPont contended that retroactive application of the 2003 amendment to 36 M.R.S.

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[1] 36 M.R.S. § 141(2)(A) provides an exception to the general three-year statute of limitations for the Assessor to make an assessment in section 141(1). The "old" version of section 141(2)(A) provided:

> An assessment may be made within 6 years from the date the return was filed if the tax liability shown on the return is less than ½ of the tax liability determined by the [Assessor] and the additional liability is attributable to information which was required to be reported but was not reported in the return.

The "new" version, as amended in 2003, provides:

> An assessment may be made with 6 years from the date the return was filed if the tax liability shown on the return, after adjustments necessary to correct any mathematical errors apparent on the face of the return, is less than ½ of the tax liability determined by the [Assessor]. In determining whether the 50% threshold provided by this paragraph is satisfied, the assessor may not consider any portion of the understated tax liability for which the taxpayer has substantial authority supporting its position.

§141(2)(A), which, when applicable, extends the statute of limitations for tax assessments from 3 to 6 years, is unconstitutional and that the assessments for the tax years 1999 and 2000 are time barred. Second, DuPont argued that, if the 2003 amendment to Section 141(2)(A) may be retroactively applied to the 1999 and 2000 tax years, the assessments are nevertheless time barred because DuPont had "substantial authority" for its inclusion of income on FECs and STMS, such that section 141(2)(A)'s extended limitations period does not apply.

On August 17, 2007, the court bifurcated DuPont's Motion in order to separately consider each of these alternative grounds. On April 4, 2008, the court entered an order rejecting DuPont's first argument and concluding that application of the 2003 version of section 141(2)(A) to DuPont's 1999 and 2000 tax returns does not constitute a violation of DuPont's constitutional right to due process.

Accordingly, the sole remaining issue now before the court is whether the assessments for those tax years are time barred under the 2003 amendment to section 141(2)(A) because, as DuPont contends, it had "substantial authority" for including gross receipts from its sale of short-term marketable securities ("STMS") and forward exchange contracts ("FECs") in the "sales factor" for apportioning its income to the State of Maine. 36 M.R.S. § 5211(8) & (14).

BACKGROUND

Except where noted, the following facts are undisputed for the purposes of the pending motion:

DuPont's 1999 Maine corporate income tax return was due on October 15, 2000 and, subject to extension, was received by Maine Revenue Services ("MRS") on November 16, 2000. Pl.'s Supp. S.M.F. ¶ 1; Def's. Opp. S.M.F. ¶ 1.[2] DuPont's 2000 Maine corporate income tax

[2] This recitation reflects Defendant's qualification of Pl.s' S.M.F. ¶ 1.

return was due on October 15, 2001 and received by MRS on that date. Pl's. Supp. S.M.F. ¶ 2; Def.'s Opp. S.M.F. ¶ 2.

According to DuPont, on each of these returns it reported the gross receipts from its sales of STMS and FECs. Pl.'s Supp. S.M.F. ¶¶ 4-5. However, following an audit, the Assessor adjusted the returns to include only the net receipts from the sales of STMS and FECs in the sales factor of DuPont's Maine apportionment formula;[3] i.e. the Assessor did not include amounts representing return of principle from these financial instruments in the sales factor. Pl.'s Supp. S.M.F. ¶ 3; Def.'s Opp. S.M.F. ¶ 3. According to the Assessor, the inclusion of these gross receipts in the sales factor was contrary to the explicit language of prior reconsideration decisions by the Assessor sent to DuPont in 1993, 1994 and 2000 regarding tax years 1985-1993. *Id.*

DuPont reported a tax liability on its 1999 return (before payments and credits) of $59,447. Pl.'s Supp. S.M.F. ¶ 6; Def.'s Opp. at ¶ 6. The total tax liability determined by the Assessor (before payments and credits) for that tax year was $164,668. Pl.'s Supp. S.M.F. ¶ 7; Def.'s Opp. at ¶ 7. According to DuPont, $96,738 of that $164,668 related to the "gross receipts issue." Pl.'s Supp. S.M.F. ¶ 7. The Assessor qualifies this assertion by saying that $94,955 rather than $96,738 of the Assessor's calculated liability related to the "gross receipts issue." Def.'s Opp. S.M.F. ¶ 7. According to DuPont, by using net rather than gross receipts for the 1999 tax year, DuPont's tax liability, as determined by the Assessor, is $67,930. Pl.'s Supp. S.M.F. ¶ 8. In large measure, the Assessor agrees, except that its calculations are slightly different, to wit: $69,713 versus $67,930. Def.'s Opp. S.M.F. ¶ 8. Thus, DuPont's reported tax

[3] Under Maine's income tax law, an apportionment formula is applied to multijurisdictional taxpayers "having income from business activity which is taxable both within and without this State." 36 M.R.S. § 5211(1).

liability for 1999 ($59,447) is more than half of the tax liability determined by the Assessor ($67,950 [or $69,713]). Pl.'s Supp. S.M.F. ¶ 9; Def.'s Opp. S.M.F. ¶ 9.

The same computational analysis is applied to the following tax year. DuPont originally reported tax liability on its 2000 Maine corporate income tax return (before payments and credits) of $55,594. Pl.'s Supp. S.M.F. ¶ 10; Def.'s Opp. S.M.F. ¶ 10. The total tax liability determined by the Assessor on audit (before payments and credits) for the 2000 tax year was $168,383. Pl.'s Supp. S.M.F. ¶ 11; Def.'s Opp. at ¶ 11. According to DuPont, $90,049 of that $168,383 related to the "gross receipts issue." Pl.'s Supp. S.M.F. ¶ 11. The Assessor qualifies this assertion by saying that $82,625 rather than $90,049 of the Assessor's calculated liability related to the "gross receipts issue." Def.'s Opp. S.M.F. ¶ 11. According to DuPont, by using net rather than gross receipts for the 2000 tax year, DuPont's tax liability, as determined by the Assessor, is $78,334. Pl.'s Supp. S.M.F. ¶ 12. The Assessor essentially agrees, except that its calculations are slightly different, to wit: $85,758 versus $78,334. Def.'s Opp. S.M.F. ¶ 12. Thus DuPont's reported tax liability for 2000 ($55,594) is more than half of the tax liability determined by the Assessor ($78,334 [or $85,758]). Pl.'s Supp. S.M.F. ¶ 13; Def.'s Opp. S.M.F. ¶ 13.

The assessment against DuPont for the 1999 and 2000 tax years was not made until September 7, 2005. Pl.'s Supp. S.M.F. ¶ 14; Def.'s Opp. S.M.F. ¶ 14.

The audit of the 1999 and 2000 returns was not the first time the Assessor and MRS had audited DuPont. Relevant to the pending appeal, the following earlier final agency reconsideration decisions were also issued to DuPont: (a) a decision issued, dated October 29, 1993, regarding DuPont's Maine income tax position for years 1985, 1986, and 1987 ("1993 MRS Decision"), Def.'s A.S.M.F. ¶ 43; Pl.'s Reply A.S.M.F. ¶ 43; (b) a decision, dated

December 9, 1994, regarding DuPont's Maine income tax filing position for years 1988, 1989, and 1990 ("1994 MRS Decision"), Def.'s A.S.M.F. ¶ 45; Def.'s Reply A.S.M.F. ¶ 45; and (c) a decision, dated February 18, 2000, regarding DuPont's Maine income tax filing positions for years 1991, 1992, and 1993 ("2000 MRS Decision"), Def.'s A.S.M.F. ¶ 47; Def.'s Reply A.S.M.F. ¶ 47. Each involved a "gross receipt" issue similar to that which is now on appeal for years 1999 and 2000 — that is, each was concerned, to some degree, with the propriety of DuPont's inclusion of the full amount of treasury receipts related to FECs and/or STMS in the denominator of its Maine sales factor portion of its apportionment formula. *See* Def.'s A.S.M.F. ¶¶ 44-48; Def.'s Reply A.S.M.F. ¶¶ 44-48.

The Assessor asserts that in those prior decisions, DuPont's attempts to include FEC and STMS receipts as part of its "gross receipts" was rejected. Def.'s A.S.M.F. ¶ 50. DuPont qualifies this assertion and contends, instead, that "in at least 2 of the decisions, the Assessor did not reject DuPont's inclusion of FEC and STMS receipts as part of its 'gross receipts'" in the Maine sales tax formula. Def.'s Reply A.S.M.F. ¶ 50. Rather, according to DuPont, the Assessor first determined that DuPont had "substantial authority" for its filing position, then utilized the provisions of 36 M.R.S. § 5211(17) to modify the statutory apportionment. *Id.*

In any event, the parties agree that in each of the 1993, 1994 and 2000 MRS Decisions, the Assessor ultimately determined that DuPont's inclusion of the gross receipts from FECs and/or STMS in the statutory apportionment formula did not fairly represent the extent of DuPont's business activities in Maine for the years at issue and unfairly represented DuPont's Maine sales factor and Maine apportionment percentage. Def.'s A.S.M.F. ¶ 51; Def.'s Reply A.S.M.F. ¶ 51.

DISCUSSION

I. Standard of Review

In the context of DuPont's motion, summary judgment is warranted if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." M.R. Civ. P. 56(c)). For purposes of summary judgment, a "material fact is one having the potential to affect the outcome of the suit." *Burdzel v. Sobus*, 2000 ME 84, ¶ 6, 750 A.2d 573, 575. "A genuine issue of material fact exists when there is sufficient evidence to require a fact-finder to choose between competing versions of the truth at trial." *Lever v. Acadia Hosp. Corp.*, 2004 ME 35, ¶ 2, 845 A.2d 1178, 1179. If ambiguities in the facts exist, they must be resolved in favor of the non-moving party. *Beaulieu v. The Aube Corp.*, 2002 ME 79, ¶ 2, 796 A.2d 683, 685.

II. Statutory Framework

The parties agree that DuPont filed the challenged tax returns in accordance with 36 M.R.S. § 5211, which deals with the apportionment of business income earned by multijurisdictional companies. Subsection 1 provides that "[a]ny taxpayer. . . having income from business activity which is taxable both within and without this State, other than the rendering of purely personal services by an individual, shall apportion his net income as provided in this section." *Id.* Subsection 8 goes on to require that "[a]ll income shall be apportioned to this State by multiplying the income by the sales factor." 36 M.R.S. § 5211(8). The "sales factor," in turn, "is a fraction, the numerator of which is the total sales of the taxpayer in this State during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period." 36 M.R.S. § 5211(14).

Under this formula, therefore, DuPont was required to multiply its income by an apportionment fraction that included its "sales in Maine" in the numerator and its "sales everywhere" in the denominator. "Sales" are defined in the apportionment statute to mean "all gross receipts of the taxpayer." 36 M.R.S. § 5210(5).

When MRS audited DuPont's 1999 and 2000 returns, it concluded that, as a result of DuPont's inclusion of gross receipts from the sale of FECs and STMS in the sales factor fraction, the apportionment formula "do[es] not fairly represent the extent of the taxpayer's business activity" in Maine. *See* 36 M.R.S. § 5211(17)[4]; and *See* Pls.' Amended Petition at Exh. 2 at 7 (hereinafter "2005 Reconsideration Decision"). Based on this decision, and under the authority granted by Section 5211(17), MRS then altered the apportionment formula for calculating DuPont's tax liability in tax years 1999 and 2000 by removing gross receipts from the sale of FECs and STMS from the denominator. It is that alteration and the resulting assessment with which DuPont takes issue.

Generally speaking, tax assessments are subject to a 3-year limitations period from the date a return is either filed or required to be filed, whichever is later. 36 M.R.S. § 141(1).[5] That

[4] 36 M.R.S. § 5211(17) reads, in relevant part:

> VARIATIONS. If the apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the tax assessor may require, in respect to all or any part of the taxpayer's business activity, if reasonable . . . [t]he employment of any other method to effectuate an equitable apportionment of the taxpayer's income.

36 M.R.S. §5211(17)(D).

[5] 36 M.R.S. § 141(1) provides:

> 1. GENERAL PROVISIONS. Unless otherwise provided, any amount of tax which a person declares on a return filed by him with the State Tax Assessor to be due to the State shall be deemed to be assessed at the time the return is filed and shall be payable on or before the date prescribed for filing the return, determined without regard to any extension of time granted for filing the return. When a return is filed, the State Tax

general 3-year limitations period is, however, subject to an exception which, when applicable, extends to 6 years the period within which assessments must be made. 36 M.R.S. § 141(2)(A).

> An assessment may be made within 6 years from the date the return was filed if the tax liability shown on the return, after adjustments necessary to correct any mathematical errors apparent on the face of the return, is less than 1/2 of the tax liability determined by the State Tax Assessor. In determining whether the 50% threshold provided by this paragraph is satisfied, the assessor may not consider any portion of the understated tax liability for which the taxpayer has *substantial authority* supporting its position.

Id. (emphasis added).

According to DuPoint, the 6-year limitations period under section 141(2)(A) does not apply and the 2005 Assessment is thus time barred because DuPont had "substantial authority" for the inclusion of the gross receipts from the sale of FECs and STMS when it completed the apportionment formula on its 1999 and 2000 tax returns. The Assessor contends that DuPont lacked "substantial authority." The parties agree, however, that, if the court concludes that DuPont had "substantial authority" for including those receipts, the 2005 Assessment was indeed time barred and, if it did not, the assessment was timely.[6]

III. <u>"Substantial Authority"</u>

In light of the above, the fundamental issue in this case is what constitutes "substantial authority" for a taxpayer's position in reporting income and whether DuPont had it in this case.

> Assessor shall cause it to be examined and may conduct such audits or investigations as he believes necessary to determine the correct tax liability. If he determines that the amount of tax shown on the return is less than the correct amount, the State Tax Assessor shall assess the tax due the State. No such assessment shall be made after 3 years from the date the return was filed or the date the return was required to be filed, whichever is later. At any time within the appropriate assessment period prescribed by this section, the State Tax Assessor may make a supplemental assessment if he finds that any previous assessment is imperfect or incomplete in any material aspect.

Id.

[6] Based on the limited scope of the issue presented, the substantive accuracy of the 2005 Assessment (e.g. whether DuPont's income, as reported under the standard apportionment formula, fairly represents the extent of its business activity in Maine) or whether MRS was justified, on the merits, in adjusting the formula is not an issue to be decided at this stage.

With respect to the meaning of "substantial authority," the parties appear to agree that that term, as it is used in the particular context of Section 141(2)(A), has not been defined by Maine statute or by the Law Court. The court's own research has not turned up any authority directly on point either. This is not to say, however, that the court is without guidance. As the parties point out, the Law Court has previously considered the meaning of "substantial authority" in the context of another tax statute related to the abatement of tax penalties. *See John Swenson Granite, Inc. v. State Tax Assessor*, 685 A.2d 425, 429 n.3 (Me. 1996) (discussing 36 M.R.S. 187-B(7)(F)).[7]

In *Swenson*, the Law Court cited with approval the definition of "substantial authority" as it is used in federal tax law. *See id.* Under that definition, "substantial authority" is

> an objective standard involving an analysis of the law and application of the law to relevant facts. The substantial authority standard is less stringent than the "more likely than not" standard . . . but more stringent than the reasonable basis standard . . . . There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment.

Id. (quoting 26 C.F.R. §§ 1.6662-4(d)(2), (3) (1996)).

In addition to the excerpt quoted by the Law Court in *Swenson*, 26 C.F.R. 1.6662-4(d)(3) contains a helpful analysis of the types of authority that may be relied upon to support (or contradict) a particular tax treatment and the extent to which an authority will constitute "substantial authority." *See* 26 C.F.R. 1.6662-4(d)(3)(ii)-(v). According to the federal regulation, "[a]pplicable provisions of the Internal Revenue Code and other statutory provisions, . . . regulations construing such statutes, . . . court cases, . . . private letter rulings" and other enumerated sources constitute "authority for the purposes of determining if there is substantial authority for the tax treatment of an item." *Id.* at 1.6662-4(d)(3)(iii). Thus, under the federal tax

[7] As the Law Court succinctly explained in *Swenson*, under 36 M.R.S. §187-B(7)(F), "[t]he State Tax Assessor shall waive or abate the penalties in cases such as this if 'reasonable cause' for the failure to pay is shown. This includes instances when 'the taxpayer has supplied substantial authority justifying the failure to file or pay . . . .'" *Swenson*, 685 A.2d at429 (quoting 36 M.R.S.A. § 187-B(7)(F)).

regulations, "a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision." *Id.* at 1.6662-4(d)(3)(ii). Additionally, the federal regulations explain that "[t]here is substantial authority for the tax treatment of an item by a taxpayer if the treatment is supported by the conclusion of a ruling or a determination letter . . . issued to the taxpayer," if the determination remains, for lack of a better term, "good law."[8]

In this case, there is no dispute that the Assessor previously issued three reconsideration decisions to DuPont dealing with the propriety of including gross receipts from the sale of FECs and STMS in the statutory apportionment formula. There is also no genuine dispute that in each of those three prior determinations MRS ultimately concluded that, as a result of inclusion of those "gross receipts", the apportionment formula was not representative of the extent of Dupont's business in Maine. However, as DuPont accurately points out, at least two of those prior determinations and adjustments to the apportionment formula were made following an

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[8] 26 C.F.R. 1.6662-4(d)(3)(iv) provides:

(A) Written determinations. There is substantial authority for the tax treatment of an item by a taxpayer if the treatment is supported by the conclusion of a ruling or a determination letter (as defined in ß 301.6110-2 (d) and (e)) issued to the taxpayer, by the conclusion of a technical advice memorandum in which the taxpayer is named, or by an affirmative statement in a revenue agent's report with respect to a prior taxable year of the taxpayer ("written determinations"). The preceding sentence does not apply, however, if --

(1) There was a misstatement or omission of a material fact or the facts that subsequently develop are materially different from the facts on which the written determination was based, or

(2) The written determination was modified or revoked after the date of issuance by --

(i) A notice to the taxpayer to whom the written determination was issued,

(ii) The enactment of legislation or ratification of a tax treaty,

(iii) A decision of the United States Supreme Court,

(iv) The issuance of temporary or final regulations, or

(v) The issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin.

audit by MRS and following an exercise by MRS of its discretionary authority to alter the statutory apportionment formula under 36 M.R.S. § 5211(17). Further, in both the 1994 and 2000 MRS Decisions, MRS expressly concluded that DuPont had "substantial authority" for its original tax treatment – meaning, inclusion of these gross receipts in the statutory formula. *See* Pl.'s Reply A.S.M.F. ¶ 50 (citing Lewandowski Aff. Ex. D and E; DuPont Dep. Ex. 1-3). Indeed, in the 2000 MRS Decision, MRS expressly concluded that 36 M.R.S. § 5210(5), which defines "sales" to mean "all gross receipts of a taxpayer," constituted "substantial authority" for DuPont's inclusion of receipts from sales of FECs and STMS. Thus, although it is true that MRS previously determined that inclusion of sales of FECs and STMS resulted in a distortion of DuPont's business activity in Maine and therefore required adjustment, it previously concluded that the language of the statute justified DuPont's failure to exclude those sales from its initial calculation. It was only upon review, and under its discretionary power, that MRS concluded that an adjustment to the standard formula was appropriate.

The parties do not dispute that MRS issued its 2000 Decision on February 18, 2000. The parties also do not dispute that DuPont filed its 1999 and 2000 returns after that date. Thus, at the time it filed the returns at issue in this case, DuPont was operating under a ruling from MRS that section 5210(5) constituted "substantial authority" for including gross receipts in its sales factor calculation. Moreover, while MRS ultimately opted to exclude those receipts, the language of section 5210(5) and its definition of "sales," did not change between the issuance of the 2000 MRS Determination and the filing of the 1999 and 2000 returns.

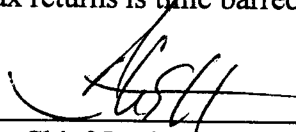
Accordingly, while the court certainly agrees that DuPont was on notice when it filed its 1999 and 2000 returns that MRS was likely to determine that the apportionment provisions of section 5211 "do not fairly represent the extent of the taxpayer's business activity" in Maine and

that MRS would also likely employ "another method to effectuate an equitable apportionment of the taxpayer's income this State" consistent with its position on the "gross receipts" issue, that notice is not dispositive in this case. 36 M.R.S. § 5211(17). Notice that MRS would use its discretionary authority to adjust the apportionment formula after filing and upon audit does not constitute notice that DuPont should not, much less could not, initially include the gross receipts under the generally applicable statutory formula,

Under Section 141(1), the State had 3 years from the date of filing to audit DuPont's returns and make the adjustments it deemed necessary. The State failed to do that. Therefore, in order for its audit to be timely under the 6-year exception in Section 141(2)(A), DuPont must have lacked "substantial authority" for the position it took. However, because the broad definition of "Sales" under section 5210(5)[9] does not appear to exclude sales of FECs and STMS, and because MRS previously advised DuPont in a reconsideration determination that the statutory definition alone constitutes "substantial authority," the court concludes that Section 141(2)(A) does not apply and the 2005 Assessment was time barred.

Pursuant to Rule 79(a) M.R. Civ. P., the Clerk is directed to enter this Order on the Civil Docket by a notation incorporating it by reference and the entry is

> The remainder of Petitioner's Motion for Partial Summary Judgment, meaning that part of the motion not covered by the court's prior Decision and Order, dated April 4, 2008, is GRANTED. The 2005 Assessment of Petitioner's 1999 and 2000 Maine corporate income tax returns is time barred.



Date: July 13, 2009

Chief Justice, Superior Court

[9] "'Sales' means all gross receipts of the taxpayer". 36 M.R.S. § 5210(5).