SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

SOVRAN BANK/D.C. NATIONAL	:	
	:	
Petitioner,	:	
	:	
v.	:	Tax Docket No. 6029-94
	:	
DISTRICT OF COLUMBIA,	:	
	:	
Respondent.	:	

MEMORANDUM OPINION AND ORDER

FACTS

The matter before the Court involves a tax dispute over the interpretation of the District of Columbia's Net Operating Loss Deduction Provision. Petitioner is a member of an affiliated group of banking institutions with members both within and without the District of Columbia. From 1988 to 1991, Petitioner apportioned all of its income to the District of Columbia and was subject to the District of Columbia Corporation Franchise Tax. Pet'r Mem. Supp. Summ. Judg., at 1, 4. During the period between 1986 and 1992, Petitioner, or its parent corporation, was acquired first by Sovran Financial Corporation, then by C&S/Sovran Corporation in 1990, and finally by Nations Bank Corporation in 1992. As it was a member of an affiliated group of corporations,

Petitioner was included in the Federal Consolidated Income Tax Returns of both Sovran Financial Corporation and its subsidiaries for the period March 11, 1986 though 1989. Similarly, Petitioner was included in the Federal Consolidated Income Tax Returns of C&S/Sovran Corporation in 1990 and 1991.

In 1991 the loss year, Petitioner, as a separate corporation, sustained a Net Operating Loss of $113,050,947.00. Of this amount, $71,141,091.00 was used by Petitioner on its 1991 Federal Consolidated Income Tax Return to offset the income of other affiliates while the remaining, $41,909,856.00, was available as a net operating loss carry back for federal income tax purposes.

On May 13, 1993, Petitioner filed FR-11 forms[1] with Respondent to claim District of Columbia corporation franchise tax refunds in the amount of $2,115,901.00 and $1,660,610.00 for periods 1989 and 1990, respectively. The refund claims were based on carry backs to 1989 and 1990, a portion of the $41,909,947 balance of the total of the 1991 net operating loss of $113,050,947.00 not used in '91 and found on Petitioner's 1991 Federal Consolidated Income Tax Return.

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[1] The Claim for refund of Income or Franchise Tax Form.

On October 22, 1993, Respondent denied Petitioner's refund claims because there was no net operating loss deduction (hereinafter "NOL deduction") shown on Petitioner's Federal Consolidated Income Tax Return for years 1989 and 1990. Pet'r Mem. Supp. Summ. J. at 6, & Exhibit 34. In response, on April 21, 1994 Petitioner filed an appeal to this Court challenging Respondent's denial of Petitioner's state franchise tax refund claims for 1989 and 1990. Petitioner filed a Motion for Summary Judgment on September 8, 1995; and on October 6, 1995 Respondent filed a cross Motion for Summary Judgment.

ANALYSIS

Both parties have petitioned this court for summary judgment on the issue of whether Petitioner's claims for net operating loss deductions for years 1989 and 1990, under D.C. Code § 47-1803.3(a)(14) (Repl. 1990) (hereinafter "the NOL provision"), were properly disallowed. Summary judgment may be granted only when "there is no genuine issue as to any material fact and ... the moving party is entitled to a judgment as a matter of law." Sup. Ct. Civ. R. 56(c) (made applicable to this tax proceeding by Sup. Ct. Tax R. 3); there must be no legal theory supporting the non-moving party's case which remains viable under the asserted facts.

Smith v. Washington Metropolitan Area Transit Authority, 631 A.2d 387, 390 (D.C. 1993).

As both parties have petitioned the Court for summary judgment, each must bear the moving party's burden for summary judgment to be granted in its favor. In their respective Motions, the parties have raised the following legal issues: (1) whether the Respondent has correctly interpreted the statute at issue; (2) whether the Respondent's interpretation of the NOL provision violates the Commerce Clause of the United States Constitution; (3) whether the Respondent's interpretation of the NOL provision violates of the Due Process Clause of the United States Constitution; and (4) whether the Respondent's interpretation of the NOL provision violates the Equal Protection Clause of the United States Constitution.

1. Statutory Interpretation

Respondent denied Petitioner's claim for a tax refund of its 1989 and 1990 taxes because there were no net operating losses shown on the Petitioner's 1989 and 1990 Federal Consolidated Corporation Income Tax Returns (Form 1139) as required by Respondent's interpretation of D.C. Code § 47-1803.3(a)(14) (Repl. 1990). The refund claims were based on a loss carry back to 1989

and 1990 of Petitioner's 1991 portion of the net operating loss of $41,909,859.00 found on their Federal Consolidated Income Tax Return for their District of Columbia activities. The District of Columbia's NOL provision reads as follows:

> Net Operating Losses.-In computing the net income of a corporation, an unincorporated business, or financial institution, there shall be allowed **a deduction** for net operating losses, **in the same manner as allowed under section 172 of the Internal Revenue Code of 1986** and **as reported on any federal tax return for the same taxable period** ... D.C. Code § 47-1803.3(a)(14) (Repl. 1990) (emphasis added).

Respondent interprets the above quoted statute as having three requirements for obtaining a NOL deduction. "[I]n order to allow a District NOL deduction, there must be (1) a federal NOL deduction, (2) reported on a federal tax return, (3) for the same taxable period [in which the District NOL deduction is claimed]." Resp. Mem. Supp. Summ. J. at 6. It is undisputed, in the present matter, that the Petitioner did not take a federal NOL deduction on its Federal Consolidated Corporation Income Tax Returns for the years 1989 and 1990.

The Court notes that its review of the Respondent's interpretation of this statute is informed and governed by the rules of statutory construction. "A cornerstone of statutory

interpretation is the rule that a court 'will not look beyond the plain meaning of a statute when the language is unambiguous and does not produce an absurd result.'" J. Frog, Ltd. v. Fleming, 598 A.2d 735, 738 (D.C. 1991). "The meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain ... the sole function of the court is to enforce it according to its terms." Caminetti v. United States, 242 U.S. 470, 485,37 S.Ct. 192 (1917). Further, an agency's interpretation of a law which it enforces is to be followed when reasonable and not in disagreement with the language of the statute. District of Columbia v. Pierce Associates, Inc., 462 A.2d 1129, 1130 (D.C. 1983); and as this case involves a District agency's interpretation of a District statute which the agency enforces, that agency's interpretation is entitled to deference from this Court.

Petitioner raises two relevant arguments in support of its assertion that the statue is ambiguous and has been incorrectly interpreted by the Respondent. First, it notes that while a deduction is to be allowed in the same manner as under § 172 of the Internal Revenue Code, the NOL provision does not require the amounts of the deductions to be the same. Second, the NOL

provision does not expressly address the situation where a taxpayer is a member of a group filing a consolidated federal return.

Petitioner states that as it filed a consolidated federal return, and was required to file a separate return in the District of Columbia, an injustice results from the District of Columbia's interpretation of the NOL provision. In essence, Petitioner asserts that the District of Columbia's interpretation of the NOL provision, coupled with the filing of separate and consolidated returns for District of Columbia taxes and federal taxes, respectively, in effect requires the Petitioner to apply its losses to the income of other entities. Pet. Mem. Supp. Summ. Judg., at 10. Petitioner asserts that the appropriate construction of the NOL provision is to determine net operating loss carry backs as if Petitioner had filed a separate federal return which in this writers mind would be tantamount to having the Respondent make a new separate return for Petitioner in order to determine a refund. Id. at 9. Petitioner points to the favorable interpretation of similar statutes by other jurisdictions' as authority for this Court to adopt Petitioner's interpretation of the NOL provision. Id. at 12-13.

The Court first notes that the NOL provision does not, as the Petitioner has stated, *require* the Petitioner to apply its NOL to its affiliates. The Petitioner may carry its loss forward for 15 years from the year in which the NOL occurred. D.C. Code § 47-1803.3(a)(14) (referring to 26 U.S.C. § 172). Should any of Petitioner's federal returns within the 15 year carry forward period contain a NOL deduction, Petitioner will then be able to claim a NOL deduction on its District return as well. Thus, Petitioner's characterization of the NOL provision as *requiring* it to apply its losses to its affiliates is erroneous.

The Court finds that the statute is unambiguous. The sentence at issue reads in relevant part as follows: "there shall be allowed **a deduction** for net operating losses, in the same manner as allowed under section 172 of the Internal Revenue Code of 1986 and **as reported on any federal tax return for the same taxable period.**" D.C. Code § 47-1803.3(a)(14) (emphasis added). The subject of the sentence and the statute is the NOL deduction mentioned therein. Thus, "as reported" must refer to the NOL deduction. Therefore, the correct interpretation of the sentence is that one shall be allowed a NOL deduction as such deduction is reported on one's federal tax return for the same taxable period.

Courts are to give deference to statutory interpretations rendered by the agency responsible for the application of a statute. Pierce Associates, 462 A.2d at 1130. The situation at hand is analogous, and the Court finds that the Respondent is entitled to summary judgement on the legal issue of its interpretation of the statute because that interpretation is reasonable.

2. Commerce Clause & Due Process

Petitioner has asserted that the Respondent's interpretation of the NOL provision violates the Commerce Clause. That clause authorizes Congress to "regulate Commerce ... among the several States." U.S. Const. Art. I, § 8, cl. 3. The clause has been interpreted to prevent states from imposing taxes which discriminate against interstate commerce by favoring local businesses. Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 329 (1977). Petitioner has also asserted that the Respondent's interpretation of the NOL provision violates the Due Process clause. U.S. Const. amend. V. As the Due Process challenge is appropriately addressed in the discussion of the Commerce Clause issue, they are discussed together below.

The Supreme Court has set forth a four prong test for determining whether a local tax violates the Commerce Clause. The test requires a Court to determine whether

> the tax [1] is applied to an activity with a substantial nexus with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). Petitioner has raised no challenge to the NOL provision under the first or fourth prongs of the Complete Auto test. Had such a challenge been made, however, the NOL provision would satisfy the requirements of those two prongs. Petitioner has its principal place of business in the District of Columbia and either earns or apportions all of its income to the District of Columbia. These factors are enough to satisfy the nexus and relation requirements of the Complete Auto test. Goldberg v. Sweet, 488 U.S. 252, 267 (1989).

Petitioner has asserted that the Respondent's interpretation of the NOL provision has violated the second and third prongs of the Complete Auto test. In claiming a Due Process violation, Petitioner challenges the apportionment of its income to the District of Columbia. As review of the NOL provision under the

Complete Auto test entails an analysis of apportionment, the Due Process challenged is analyzed within that discussion, found in the external consistency test analysis which follows.

a. Fair Apportionment

The second prong of the Complete Auto test examines whether the tax is fairly apportioned. To determine whether a tax is fairly apportioned the Court must inquire whether the tax is both internally and externally consistent. Goldberg v. Sweet, 488 U.S. 252, 261 (1989).

1. Internal Consistency

The internal consistency test inquires whether multiple taxation would result if every state were to impose an identical tax. Id. at 261. The NOL provision is not a tax at all, but rather, is a credit. As such, the NOL provision is internally consistent because by its very nature a credit cannot result in multiple taxation

If all states were to adopt NOL provisions identical to the one presently at issue, taxpayers would have to claim a NOL deduction on their federal tax returns before they could claim state NOL deductions. One potential result of such a circumstance would be the possibility of increased tax liability due to a

reduced availability of NOL deductions. Such a result is a reduction in the availability of a deduction, not multiple taxation, and the Court is unaware of any case which states that a reduction in the availability of a deduction violates the internal consistency test. Deductions are not granted by right, but by legislative grace, and the legislature may allow or disallow them at its discretion. Von Stauffenberg v. District Unemployment Compensation Board, 269 A.2d 110, 111 (D.C. 1970); *aff'd* 459 F.2d 1128; *see also* Commissioner of Internal Revenue v. Sullivan, 356 U.S. 27, 28 (1958). In light of the foregoing, the Court finds that the NOL provision is internally consistent.

2. External Consistency and Due Process

For a tax provision to be externally consistent it must tax "only that portion of the revenues from interstate activity which reasonably reflects the in-state component of the activity being taxed." Goldberg, 488 U.S. at 262. Due Process also requires that only the in-state portion of interstate commerce is taxed by a state. In the instant matter, Petitioner's net operating loss was wholly apportioned to the District of Columbia and Petitioner was subject to tax therein. Pet'r Mem. Supp. Summ. J. at 1, 4; Resp. Mot. Summ. Judg., at 16. The statutes which define income

taxable by the District of Columbia are exhaustive in their exclusion of income from sources outside the District. D.C. Code §§ 47-1807.1(2), 47-1810.1 to .3 (Repl. 1990).

Taxpayers are also authorized to petition for the utilization of alternative methods of apportionment or calculation "[i]f the allocation or apportionment provisions ... do not fairly represent the extent of the taxpayer's business activity in the District." § 47-1810.2(h). Petitioner has not challenged the effectiveness of these statutes in guarding against taxation of income from outside the District.

Further, the statute provides for petition of erroneous apportionments or allocations. The Petitioner is barred from now challenging the apportionment of its income to the District of Columbia because Petitioner failed to exhaust the available administrative remedies for such a challenge. Smoot Sand and Gravel Corp. v. District of Columbia, 261 F.2d 758, 765-66 (D.C. Cir. 1958) (discussing D.C. Code § 47-1580a (1951), the statutory predecessor of D.C. Code § 47-1810.2). The Court finds that all of the aforementioned statutory provisions, which operate in conjunction with the NOL provision at issue, insure that only the in-state portion of interstate income is taxed by the District of

Columbia. The statutory scheme therefore satisfies the external consistency test and affords the process due to aggrieved parties. Thus, the second prong of the Complete Auto test is satisfied.

b. Discrimination Against Interstate Commerce

The third prong of the Complete Auto test inquires whether the tax discriminates against interstate commerce. The Supreme Court has stated that the Commerce Clause is not designed to protect state residents from their own state taxes. Goldberg v. Sweet, 488 U.S. 252, 266 (1989). In Goldberg, the Court stated that when the disproportionate burden of a tax falls on state residents, rather than on non-residents, the resident will be able to petition the government for reform of the law through the political process. Id. at 266. The Commerce Clause is fashioned to protect the non-resident because that class of persons is unable to affect political change. Id.

In the instant matter, Petitioner is an entity whose principal place of business is in the District of Columbia, and whose income or losses are apportioned entirely to the District of Columbia. As such, Petitioner is within that class of persons which the Commerce Clause was not designed to protect. As was noted in Goldberg, Petitioner "presumably is able to complain

about and change the tax through the [District of Columbia] political process. It is not a purpose of the Commerce Clause to protect state residents from their own state taxes." Id. at 266. The Court finds that the Respondent's interpretation of the NOL provision does not violate the third prong of the Complete Auto test. Having also found, as described above, that the Petitioner's interpretation of the NOL provision does not violate the other prongs of the Complete Auto test, the Court holds that the Petitioner's interpretation of the NOL provision does not violate the Commerce Clause or the Due Process clause of the United States Constitution.

3. Equal Protection

Petitioner has asserted that Respondent's interpretation of the NOL provision violates the Equal Protection clause of the United States Constitution. The Court notes that the due process clause of Fifth Amendment renders an equal protection analysis applicable to the District of Columbia. Bolling v. Sharpe, 347 U.S. 497 (1954); Jones v. District of Columbia, 585 A.2d 1320 (D.C. 1990).

Legislatures possess broad discretion in making classifications in the field of taxation. Madden v. Commonwealth

of Kentucky, 309 U.S. 83, 87-88 (1940); Regan v. Taxation With Representation Of Washington, 461 U.S. 540, 547 (1983). Tax classifications are valid if they bear a rational relationship to a legitimate governmental purpose. Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869, 881 (1985). In reviewing tax classifications,

> the presumption of constitutionality can be overcome only by the most explicit demonstration that the classification is a hostile and oppressive discrimination against the particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

309 U.S. at 88; *see* Regan v. Taxation With Representation Of Washington, 461 U.S. 540, 547 (1983). The Court here reviews Respondent's interpretation of the NOL provision under the above cited deferential standards.

Respondent has advanced administrative convenience as the legitimate basis supporting the requirement that an NOL deduction be taken on one's federal return before a taxpayer may claim a NOL deduction on its District return. In challenging Respondent's asserted basis supporting the NOL provision, Petitioner has cited two cases from foreign jurisdictions. In Searle Pharmaceutical v. Department of Revenue, 512 N.E.2d 1240 (Ill. 1987), an Illinois law which classified taxpayers in reference to their federal

returns was found to violate the uniformity clause of the state constitution. Petitioner has also cited Department of Revenue v. Amrep Corporation, 358 So.2d 1343 (Fla. 1978), which finds unconstitutional a law which discriminated against interstate commerce.

For the reasons discussed below, the Court finds that Petitioner has failed to carry its burden in establishing that the NOL provision is unconstitutional under the Equal Protection Clause. First, the Court notes that neither of the cases cited by the Petitioner are controlling in the present matter as both are state court decisions from foreign jurisdictions.

Second, the decision in Amrep is doctrinally distinct from the matter before the court. In that case, the Court was faced with an Equal Protection Clause challenge to a law which discriminated between resident and non-resident corporations. Id. at 1345. The Petitioner in that case was a nonresident entity, and the analysis employed by the Court was applicable to challenges brought by non-resident entities. Id. at 1353.

In the present matter, there is no such discrimination. The NOL provision distinguishes between corporations on the basis of whether they took a deduction on their federal tax returns, not by

resident and non-resident status. The NOL provision therefore does not distinguish between resident and non-resident corporations. Further, legislatures have long been permitted to employ classifications in taxation. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1937) ("This Court has repeatedly held that inequalities which result from a singling out of one particular class for taxation or exemption, infringe no constitutional limitation."). The Court finds that Amrep is inapposite in the present matter.

Third, the decision in Searle Pharmaceutical reviewed a tax provision under the Uniformity Clause of the Illinois Constitution. In discussing the Petitioner's burden, the court in Searle Pharmaceutical stated that the Uniformity Clause provided "the taxpayer protection beyond that of the equal protection clause." Id. at 1246. In light of this statement, the Court feels that using this case as precedent for any decision regarding taxation under the Equal Protection Clause would be erroneous. The Court is unaware of a similar heightened standard of review in the District of Columbia. All that is required is that the classification employed be reasonable and rationally related to the object of the tax statute. *See* Getty Oil Co. v. Oklahoma Tax

Commission, 563 P.2d 627, 630 (Okla. 1977); *dismissed* 434 U.S. 804 (1977). (a case strikingly similar to the present case, but involved carrying losses forward rather than backwards and resulting in the same statutory interpretation that Respondent herein asserts).

Finally, the Supreme Court has long recognized that administrative convenience or necessity is a legitimate or reasonable state interest in taxation. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 511 (1937); Packer Corporation v. Utah, 285 U.S. 105, 110, fn. 6 (1932). This is precisely the interest which the Respondent has advanced in support of the NOL provision. Resp. Mem. Supp. Summ. Judg., at 10. Requiring a federal NOL deduction in order to qualify for a NOL deduction in the District is rationally related to the legitimate state interest advanced by the Respondent. Such a requirement certainly makes the government's task of reviewing tax deductions easier.

It is the Petitioner's burden "to negative every conceivable basis which might support [the legitimate state interest]." Madden v. Commonwealth of Kentucky, 309 U.S. at 88. Petitioner has failed to negative the basis for the NOL provision advanced by the Respondent, and has certainly failed to negate every

conceivable basis for the NOL provision. Accordingly, Petitioner has failed to establish that Respondent's interpretation of the NOL provision violates the Equal Protection Clause of the United States Constitution.

CONCLUSION

Petitioner has failed to advance any viable legal theory in support of its statutory interpretation which remains viable following the Court's review of the facts and legal arguments. The the Court finds that the Respondent's interpretation of the NOL provision is reasonable and suffers from no Constitutional deficiencies as alleged. The Court finds that Respondent is entitled to Summary Judgment as a matter of law.

Several other states facing the same or similar question have held that statutes referring to the federal NOL deduction require that the computation of a taxpayer's state NOL conform to the computation of its federal NOL. See Heftler Constr. Co. v. Florida Dept. of Revenue, 438 So. 2d 139 (Fla. App. 3 Dist. 1983), review denied 449 So. 2d 264 (Fla. 1984). Scholastic Bus Service, Inc. v. State Tax Commission, 498 N.Y.S. 2d 278 (1986); Postal Finance Co. v. Oklahoma Tax Com. 594 P.2d 1205 (Okla. 1977);

Utica Bankshares Corp. v. Oklahoma Tax Comm'n, 892 P.2d 979 (Okla. 1994).

Therefore, based upon the foregoing, it is this 3rd day of December, 1997,

ORDERED, that the Petitioner's Motion for Summary Judgment is hereby **DENIED**, and Respondent's Motion for Summary Judgment is hereby **GRANTED**.

W. P. Gardner

JUDGE WENDELL P. GARDNER, JR.
Signed in Chambers

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