Opinion No. 65-206

October 18, 1965

BY: OPINION OF BOSTON E. WITT, Attorney General Tom Overstreet, Assistant Attorney General

TO: Commissioner Max M. Gonzales, Bureau of Revenue, State of New Mexico, Santa Fe, New Mexico

QUESTION

FACTS

The Internal Revenue Code of the Federal Government contains a provision whereby a net operating loss in a particular year can be carried back three years and carried forward five years if necessary to absorb the loss. This is referred to as the carry-back-carry-forward feature of a net operating loss. There are many conditions and calculations to abide by, but the basic feature is this. A taxpayer has net income of $ 10,000 in year 1962, $ 15,000 in year 1963, $ 5,000 in 1964, and then a net operating loss in 1965 of $ 20,000. Under the Federal Code, the taxpayer can take the $ 20,000 loss in 1965 and use it to reduce the net income in the year of 1962 to zero and use the remainder of the loss in 1963. The taxpayer would be entitled to a refund for the years of 1962 and 1963. As far as the Federal Return is concerned, the taxpayer's taxable income for those years has been reduced to the lower figures. In the event the loss is not absorbed in 1962, 1963 or 1964, the loss could be applied to any net income in the subsequent five years, following the year 1965.

QUESTION

Is a net operating loss to be accorded the same treatment under the New Mexico Income Tax Act as it is by the Internal Revenue Code?

CONCLUSION

Yes.

OPINION

*{*335}* ANALYSIS

Section 72-15-21, N.M.S.A., 1953 Compilation, levies the New Mexico Income Tax upon the taxpayer's net income. Section 72-15-6, N.M.S.A., 1953 Compilation, defines net income as follows:

A. "Base income" of a taxpayer means that part of the taxpayer's income generally defined as federal taxable income and upon which the federal income tax is calculated less the federal income tax payable for the taxable year.

B. The "net income" of all taxpayers shall be the "base income" adjusted to provide that:

(1) Amounts that have been taxed as income in a previous year by the state shall not be taxed again;

(2) Amounts, including net operating losses, that have been deducted in a prior year's computation of state income tax liability shall not be deducted again;

(3) Amounts included in base income that the state is prohibited from taxing because of the provisions of the federal constitution, the state constitution or federal laws shall be deducted; and

(4) The full amount of the federal capital gains deductions for the taxable year shall be added to the base income if not included in that figure and shall be subject to state income tax.

Under this statute, the results of which are not changed by Laws of 1965, Ch. 202, Section 2, New Mexico has defined Net Income with certain adjustments and is one of about twenty states that tax state income by reference to the Internal Revenue Code. Many of the states that do this have a specific provision in the state code to disallow or allow the carry-back-carry-forward feature of a net operating loss. New Mexico has no such provision. In some of the other states, which do not have a specific provision, the courts have almost unanimously held that the net operating loss shall be allowed as a deduction.

*{*336}* In the case of **Commonwealth v. Chambersbury Engineering Co.,** 134 Atl 408, 287 Pa. 54 (1926), the statute read:

The term 'net income' as used in this act, shall mean net income for the calendar or fiscal year as returned to the federal government, together with all interest and dividends.. Section 1 (Pa.St.Supp. 1924 Sec. 20508a-1).

The question specifically was: In ascertaining the net income for the year, are net losses sustained by defendant for the two prior years 1921 and 1922 deductible for the purpose of fixing the amount on which tax is to be paid because they are deductible under the federal income tax statute?

The arguments and conclusion of the court were as follows:

Appellant contends that the net income of a corporation upon which the emergency profits tax is to be paid is the amount of net income upon which income tax is required to be paid to the United States. We do not so construe the act. It defines net income as

the net income returned to the federal government, not that on which tax is paid to it, and assesses the tax "upon each dollar of the net income of such corporation" during the two years of 1923 and 1924. From no language of the act can the inference arise that, so far as the state of Pennsylvania is concerned, losses sustained in prior years are to be deducted from the net income for the two enumerated years. Appellant argues that, because of the requirement that a copy of the income tax report as made to the federal government be furnished to the auditor general, the legislative intent must have been that it is upon the net income, after such allowances and deductions as the federal authorities shall permit, that the emergency profits tax is to be paid. But our act does not so stipulate. It assesses the tax on the actual net income for the named years, not the sum to be taxed as arrived at by the federal authorities after such deductions as may seem proper to them.

After the decision in this case, the Pennsylvania Statute was changed to define net income as "net income for the calendar year or fiscal year as returned to **and ascertained** by the Federal Government." 72 P.S. Section 3420A. (Emphasis added.)

In construing this language, the court in **Commonwealth v. Budd Co.,** 108 A2d 563, 370 Pa. 159 (1954), held:

. . . we now hold that this necessarily means gross income less all the deductions and carryback losses ascertained and allowed taxpayer by the Federal Government under the Revenue Act of 1942.

This court further said, p. 569:

The case of **Commonwealth v. Chambersburg Engineering Co.,** 287 Pa. 54, 134 A. 408, is distinguished because inter alia, the tax base there was the net income as returned to -- not ascertained -- by the Federal Government. In the instant case neither the Commonwealth nor either of these defendants could know the net income which was its taxable base for the year 1944 until the Federal Government had finally ascertained the taxpayer's 1944 net income after deducting net operating losses incurred in 1946.

With only a slight change in the definition of net income, the Pennsylvania Court was willing to allow the deduction of a net operating loss.

In the case of **Charlton Woolen *{*337}* Co. v. Commonwealth,** 147 N.E. 594, 252 Mass 193 (1925), net income was defined as the net income for the taxable year as required to be returned by the corporation to the federal government under the Federal Revenue Act. The taxpayer per federal return had deducted a loss occurring in 1921 on his 1923 tax return and the question was whether or not this was proper for the State Tax Commissioner to allow such deduction for the state. The court said in allowing the deduction:

The tax is to be levied in accordance with the statute, by which the net taxable income of the petitioner is to be measured by the net income for the taxable year required to be returned to the federal government under the Federal Revenue Act of nineteen hundred and twenty-one'. The petitioner made such return prior to April 1, 1923, and if under that return, the accuracy of which is not challenged, the loss was apparently deductible it should have been so treated in the assessment of the state tax.

The language in this Massachusetts case was similar to the earlier Pennsylvania Case, but the court readily allowed the operating loss deduction. Section 72-15-6, supra, appears to be even stronger in binding New Mexico to the Internal Revenue Code than the language construed by the Massachusetts and Pennsylvania courts. The statute in New Mexico does not stop at net income as returned to or ascertained by the federal government, but goes one step further and ties state net income to federal taxable income upon which the federal income tax is calculated.

The state of South Carolina adopted the Federal Income Tax Law and provided for a state income tax equivalent to one-third of the federal tax, which language appears to be closer to New Mexico in that a figure other than federal net income is used. In the case of **Lancaster Cotton Mills v. South Carolina Tax Commission,** 129 S.E. 429, 132 SoC 466 (1925), the taxpayer had charged against profits for the year 1922 a net loss of $ 200,000 from prior years. The State Tax Commission contended this deduction should not be granted and levied the tax for the year 1923 on the income and expenses for that year only. After pointing out that the state of South Carolina had adopted the federal income tax law, the court at page 431 stated:

It follows, therefore, that, since the State Tax Commission is governed by the acts of Congress and the rules and regulations made in pursuance thereof, and since the federal government has received and approved the income tax return made by the petitioner based on the fiscal year commencing July 1, 1920, and ending June 30, 1921, it was the duty of the State Tax Commission to receive and approve such return and to credit against the income for the fiscal year 1921-22 that loss which the Treasury Department of the federal government allowed as a loss, as accrued from January 1, 1921 to June 30, 1921, and that the basis of taxation set up by the state tax department cannot prevail.

Except for the earlier Pennsylvania case, which holding was circumvented by statute, research has revealed no jurisdiction which has disallowed the net operating loss deduction where there is no provision regarding such deduction and the state income statute is tied to the Internal Revenue Code. However, there are numerous cases which hold that a tax deduction cannot be taken unless there is specific statutory authority for taking the deduction. There is also authority for the proposition that only items can be deducted which occur in the particular taxable year. Based on these two well established *{*338}* principles, it could be argued that the net operating loss cannot be deducted in New Mexico in that there is no specific authority for such deduction and that it certainly could not be carried back or forward because the loss occurred in a different taxable year. If this reasoning were to prevail, it would be in direct conflict with the cases

in other jurisdictions. This argument would also defeat a number of other deductions permitted by the Internal Revenue Code in arriving at federal taxable income, which in our opinion, was not intended by the legislature.

It is therefore our opinion that New Mexico is bound by any credits, deductions or exemptions that a taxpayer is allowed on his federal return in the computation of federal taxable income. This would include the treatment accorded a net operating loss.