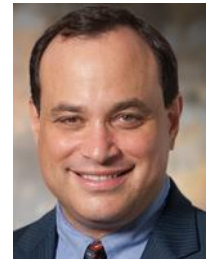


# Maine Residents Can't Deduct NH Business Taxes

By **Jonathan Block** August 14, 2018, 2:41 PM EDT

Maine and New Hampshire share a long border and a mountain range but have very different taxation schemes. One of those differences gave rise to a recent challenge to Maine's income tax credit for taxes paid to other states by Maine residents.



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Maine, like most states, follows the federal income tax treatment of passthrough entities. New Hampshire does not. New Hampshire imposes its business profits tax and business enterprise tax directly on the business organization, regardless of whether the entity is treated as a pass-through for federal income tax purposes. New Hampshire does not impose income taxes on individuals, except on interest and dividends. Maine provides a resident individual with an income tax credit for income tax imposed on that individual in other states. Since the New Hampshire taxes (other than its interest and dividends tax) are imposed at the entity level and not on the individual, this mismatch of laws creates, at least in substance, what feels to some Maine resident taxpayers like double-taxation of the same income. Two Maine resident taxpayers recently challenged this result by attacking both Maine Revenue Services' interpretation of the Maine tax credit statute and the tax credit statute's constitutionality.

In its Aug. 2, 2018, decision, *Goggin v. State Tax Assessor*,<sup>[1]</sup> the Maine Supreme Judicial Court held that the business and consumer court correctly denied Maine residents (in this case, married individuals) an individual income tax credit for the business taxes imposed by New Hampshire on income earned by a New Hampshire limited liability company owned in part by one of the spouses. The New Hampshire LLC was classified as a partnership for federal and Maine income tax purposes so income derived from its ownership was taxed by Maine on a pass-through basis as part of the adjusted gross income of the spouses. New Hampshire, however, imposed its entity-level business profits and business enterprise tax on the LLC. The LLC paid these taxes to New Hampshire for each of the years at issue.

The operative language in Maine's tax credit statute<sup>[2]</sup> provides that "a resident individual is

allowed a credit against the tax otherwise due under this part ... for the amount of income tax imposed on that individual for the taxable year by [another state].” Since the New Hampshire tax is technically imposed on the pass-through entity and not on the individual, Maine Revenue Services has historically denied the credit in these circumstances. However, to a Maine resident taxpayer who is an owner or member of a pass-through entity doing business in New Hampshire, the unavailability of the Maine tax credit feels like double taxation.

The taxpayers in *Goggin* argued that the business taxes imposed on the LLC are functionally the same as income taxes on the individual members of the LLC due to the flow-through nature of income realized by an LLC. Therefore, the taxpayers contended that Maine Revenue Services’ failure to interpret Maine’s tax credit statute to allow the Maine income tax credit in these circumstances resulted in double taxation of Maine residents having an interest in pass-through entities doing business in neighboring New Hampshire.

The court’s decision upholds Maine Revenue Services’ longstanding position that the credit provided by Section 5217-A for taxes imposed on Maine resident individuals is not available for taxes that are imposed by New Hampshire (or any other state) on a pass-through entity, rather than directly on the resident individual. In construing the tax credit statute strictly, the court relied on the principles that tax exemptions and credits must be construed narrowly and are not to be applied “to situations not clearly coming within the scope” of the statutory provisions.[3] With this statutory construction backdrop, the court held that the plain meaning of an “income tax imposed on an individual” excludes taxes that are imposed on, and paid by, pass-through business entities.[4] The court was also influenced by its observation that the taxpayers’ argument would have resulted in a “small windfall to them” because the New Hampshire taxes paid by the LLC had been deducted from their adjusted gross income and the taxpayers would have also received a Maine tax credit for a proportionate share of the taxes that the LLC paid to New Hampshire.[5]

The taxpayers further argued that Maine’s statute is unconstitutional as applied to them, because the commerce clause prohibits state tax schemes that do not credit individuals for their income taxes paid in other states.[6]

The Maine Supreme Court held that nothing in *Wynne* dictates that an individual must receive credit for taxes imposed on a business entity formed in another state by the taxing authority of that state.

The Maine Supreme Court reasoned that *Comptroller of the Treasury v. Wynne* did not apply to the facts at issue because, unlike in *Wynne*, the *Goggin* facts do not give rise to internal inconsistency. The Maine Supreme Court found that “[a]pplying the internal consistency test, if all states had Maine’s tax statutes — including its statutes regarding the taxation of pass-through entities — there would be no disproportionate taxation of out-of-state income.”[7] The issue in *Goggin* was caused by a mismatch between New Hampshire’s “unusual scheme” and Maine’s tax statutes, not a problem with the internal consistency of Maine’s tax statutes.

The Maine Supreme Court also rejected an argument that the failure to grant a credit violated the Constitution under the “external inconsistency” test, which it described as a test examining “the economic justification for the state’s claim upon the value taxed, to discover whether a state’s tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state.”[8] The court simply notes that this test has not been applied to individual income taxes, “likely because of the established legal principle that residence in a state and the consequent enjoyment of the protection of its laws provide a basis for the taxation of individuals’ income.”[9]

It is unlikely that Maine’s legislature will change its tax credit statute to accommodate New Hampshire’s unusual taxation scheme anytime soon. Attempts to change Maine’s tax credit statute in the past have failed. The bottom line is that Maine resident taxpayers who own pass-through entities doing business in New Hampshire will continue to feel unfairly taxed.

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[1] [Goggin v. State Tax Assessor](#) , 2018 ME 111.

[2] Me. Rev. Stat. tit. 36, § 5217-A .

[3] Goggin, 2018 ME 111, ¶ 13.

[4] Goggin, 2018 ME 111, ¶ 16.

[5] Goggin, 2018 ME 111, ¶ 18.

[6] See *Comptroller of the Treasury v. Wynne* , 135 S. Ct. 1787 (2015).

[7] Goggin, 2018 ME 111, ¶ 26.

[8] Goggin, 2018 ME 111, ¶ 28 (quoting *Okla. Tax Comm'n v. Jefferson Lines Inc.* , 514 U.S. 175, 185 (1995)).

[9] Goggin, 2018 ME 111, ¶ 28.