BEFORE THE TAX APPEAL BOARD OF THE STATE OF DELAWARE

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| MANUFACTURERS HANOVER LEASING INTERNATIONAL CORP., as successor to Chase Manhattan Service Corp., | ) | |
| Petitioner, | ) | |
| v. | ) | No. 1291 |
| DIRECTOR OF REVENUE, | ) | |
| Respondent. | ) | |



DECISION AND ORDER

The issue before the Board is whether petitioner's net operating loss ("NOL") carry forward is a "applicable or related expenses," as that term is used within 30 Del. C. § 1903(b)(1) ("Section 1903(b)(1)"). We have concluded that petitioner's NOL is such an expense and, thus, that judgment should be entered in its favor.

Petitioner Manufacturers Hanover Leasing International Corp. is a Delaware corporation which is principally involved in the leasing of tangible personal property on a multi-state basis. Petitioner reported a NOL with respect to its leasing operations for tax years 1981 through 1989 and 1992. A NOL represents the excess of costs and expenses incurred in each year over income derived the same year.

Section 1903 sets forth the manner in which a corporation's income is taxed in Delaware.[1] In pertinent part, Section 1903 provides:

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[1] Section 1903 has a two step process. First, all portions of a corporation's income which can be identified as having been generated within a particular state is allocated to that state. Second, any unallocated income is then apportioned among all states pursuant to a formula. All of Petitioner's leasing income can be identified as having been generated within a particular state and, thus, all of its income is allocated to particular states and none is apportioned among all states.

> "Taxable income" subject to taxation under this chapter means the portion of the entire net income of a corporation which is allocated and apportioned to this State in accordance with the following provisions:
>
> (1) Rents and royalties (less applicable or related expense) from tangible property shall be allocated to the state in which the property is physically located . . . .

When Petitioner calculated its 1993, 1994 and 1995 income pursuant to the foregoing provision, it reduced its income by the NOLs. Petitioner decreased its taxable income by classifying the NOLs as applicable and related expenses and carrying them forward to its 1993, 1994 and 1995 tax returns. The Director concedes that Petitioner calculated correctly NOL in each year, but contends it cannot carry the NOL forward. The parties have stipulated that the expenses which are embodied in the NOL are of a kind that would be included as "applicable and related expenses" within the meaning of Section 1903(b)(1) if such expenses had been incurred in 1993, 1994 or 1995. The tax in controversy is $38,473.38, and the Director seeks an additional penalty of $2,637.89.

The term "applicable and related expenses" is not defined in Section 1903 or any other provision of the Delaware tax code and, thus, we must determine the General Assembly's intent when adopting the language. In doing so, we are required to give the statutory language its ordinary and plain meaning.

Applying these principles, we read Section 1903(b)(1) as permitting Petitioner to reduce its 1993, 1994 and 1995 income by the NOL incurred from 1981 through 1989 and 1992. Although the Director raises a number of arguments, there is no real dispute that the expenses which created the NOLs are related to the income generated by Petitioner's leasing business. The Director admitted this when he stipulated that if the expenses which generated the NOLs had

been incurred in the tax years at issue, Petitioner could deduct such expenses from its income.[2] As the expenses embodied in the NOLs are related to Petitioner's income, the plain language of Section 1903(b)(1) allows Petitioner to reduce its income by the NOLs.

One of the Director's arguments in his brief was that the NOL is a deduction and not an expense and thus it cannot be used to offset income under Section 1903(b)(1). At oral argument, the Director recognized that a NOL deduction is "an expense. An NOL deduction is generated from expenses, but expenses incurred in other years." (Transcript at 26-27) Even without this concession, however, the Director's effort to characterize the NOL as a deduction fails. Simply put, the fact that the expenses embodied by the NOLs are separated from the 1993, 1994 and 1995 income by an accounting construct does not sever the relationship between the expenses and the income. If the General Assembly had intended that the only "expenses" which could be used to offset income were those incurred in the tax year at issue, it could have included qualifying language making this clear. The absence of such language and the plain terms of the statute lead us to conclude that the term "expense" in Section 1903(b)(1) is not limited just to expenses incurred in the subject tax year.

We further disagree with the Director's reading of Section 1903(b)(1) because his reading of the statute allows a taxpayer with apportionable income to use the NOLs to offset income

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2 Whether or not a particular expense embodied within a NOL is related to allocable income such that they can be used to reduce such income is a fact based question that is dependent upon the circumstances of each case. We need not address that issue here as the Director has stipulated that "[t]he NOL was attributable to petitioner's leasing operations in 1981 through 1989 and 1992 . . . and represents the excess of costs and expenses incurred in those years over income derived in those years" and that "the expenses which are now embodied in the NOL are of a kind that would be included in 'applicable or related expenses' within the meaning of Del. C. § 1903(b)(1) if such expenses had been incurred" in 1993, 1994 and 1995. Thus, the expenses underlying Petitioner's NOL relate to Petitioner's leasing operations which generated Petitioner's 1993, 1994 and 1995 allocable income.

while a taxpayer, such as the Petitioner, who has only allocable income cannot. The Delaware tax structure - which levies a tax on "the entire net income of a corporation which is allocated and apportioned to this State"[3] - does not support such a wide disparity in treatment based solely on whether a taxpayer's income can be characterized as allocable or apportionable.

For the foregoing reasons, judgment is issued in favor of Petitioner.

Joan M. Winterton

Regina C. Kiedaisch

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3/12/04

3 30 Del. C. § 1930(b)