

**BOARD OF TAX APPEALS
STATE OF LOUISIANA**

**BILLY AND CONNIE FORET,
PETITIONERS**

VS.

DOCKET NO. 13233C

**DEPARTMENT OF REVENUE,
RESPONDENT**

JUDGMENT AND REASONS

This matter came before the Board for a hearing on the merits on April 5, 2023. Presiding at the hearing were Francis J. "Jay" Lobrano, Chairman, Vice-Chairman Cade R. Cole, and Judge Lisa Woodruff-White (Ret.). Present before the Board were Miranda Scroggins, attorney for the Department of Revenue (the "Department") and Douglas Boudreaux, an Enrolled Agent representing Billy and Connie Foret (collectively "Petitioners"). At the conclusion of the hearing, the Board took the matter under advisement. The Board now issues Judgment in accordance with the attached written reasons:

IT IS ORDERED, ADJUDGED AND DECREED that there be Judgment in favor of the Petitioners and against the Department and that the Assessment bearing Letter ID: L0358331664 is hereby CANCELED.

**JUDGMENT RENDERED AND SIGNED at Baton Rouge,
Louisiana, this 13TH day of July, 2023.**

FOR THE BOARD:



**Francis J. "Jay" Lobrano, Chairman
Louisiana Board of Tax Appeals**

**BOARD OF TAX APPEALS
STATE OF LOUISIANA**

**BILLY AND CONNIE FORET,
PETITIONERS**

VS.

DOCKET NO. 13233C

**DEPARTMENT OF REVENUE,
RESPONDENT**

REASONS FOR JUDGMENT

This matter came before the Board for a hearing on the merits on April 5, 2023. Presiding at the hearing were Francis J. “Jay” Lobrano, Chairman, Vice-Chairman Cade R. Cole, and Judge Lisa Woodruff-White (Ret.). Present before the Board were Miranda Scroggins, attorney for the Department of Revenue (the “Department”) and Douglas Boudreaux, an Enrolled Agent representing Billy and Connie Foret, (collectively “Petitioners”). At the conclusion of the hearing, the Board took the matter under advisement. The Board now issues the attached Judgment for the following reasons.

Background and Facts

Petitioners are the sole shareholders of BJF, Inc. (the “Corporation”), a Louisiana corporation. The Corporation is an S corporation, meaning that the items of income, gain, deduction and loss of the Corporation pass-through to the Petitioners, who then report such items on their individual Federal and State income tax returns. For the 2019 tax year, the Corporation sold a commercial fishing vessel (the “Vessel”), which sale is the subject of the dispute in this case. The Vessel was constructed by the Corporation sometime in 2016. The construction of the Vessel was

partially funded with proceeds from a Capital Construction Fund established by the Corporation under Section 607 of the Merchant Marine Act (46 U.S.C. 53501, *et seq.*) (the "Act"). As the resolution of this case turns on the application of the federal tax rules under the Act, a brief summary of the Act and the Capital Construction Fund rules is helpful.

The Capital Construction Fund program was enacted by Congress in 1936. The Capital Construct Fund program was created as an incentive to owners and operators of U.S. flagged vessels to modernize and expand the U.S. Merchant Marine Fleet. The Act applies to both commercial vessels engaged in the non-contiguous domestic trade, but also to commercial fishing vessels. Pursuant to Internal Revenue Code ("IRC") Section 7518(c), certain deposits made into an approved Capital Construction Fund are excluded from taxable income. Mechanically, the deposit is an adjustment to a taxpayer's federal taxable income, as opposed to a taxpayer's gross income. Regardless, those deposits reduce a taxpayer's taxable income, providing a substantial tax benefit to the taxpayer. Earnings in the Capital Construction Fund grow tax free. By contract with the U.S. Department of Transportation, Maritime Administration, the owner of a Capital Construction Fund agrees in principle that the funds in the Capital Construction Fund will be used to construct new vessels.

IRC Section 7518(f) provides withdrawals from the Capital Construction Fund that are used to construct a qualifying vessel reduce the cost basis of the vessel for federal income tax purposes. Thus, for example, if a taxpayer constructs a vessel at a cost of \$1 million, and

funds \$400,000.00 of that construction with withdrawals from a Capital Construction Fund, the cost basis of the vessel is reduced by \$400,000.00 to a basis of \$600,000.00. If the vessel were sold the following year for \$900,000.00, the total gain for federal income tax purposes would be \$300,000.00.

Louisiana does not recognize the Capital Construction Fund tax incentive. Thus, while qualifying deposits into a Capital Construction Fund reduce a taxpayer's federal taxable income, such deposits do not reduce a taxpayer's Louisiana taxable income. While it logically follows that the concomitant reduction in cost basis for federal income tax purposes should not apply for state income tax purposes, because the starting point for the computation of Louisiana taxable income begins with federal Adjusted Gross Income ("AGI"), the Department contends that a taxpayer's cost basis in a vessel for state income tax purposes is equal to the cost basis for federal income tax purposes, with no adjustment for this disparity in tax treatment allowed. This is the issue in the instant case.

Turning to the facts of the instant case, sometime prior to 2019, the Corporation constructed the Vessel for a total cost of \$636,132.00. The Corporation made qualified withdrawals from its Capital Construction Fund totaling \$313,790.00 to partially fund the construction of the Vessel.¹ In 2019, the Corporation sold the Vessel for a sales price of

¹ For the 2016 tax year, Petitioners reduced their Louisiana taxable income by the amount of the deposit made to the Capital Construction Fund in that same year. The Department denied the reduction on the basis that Louisiana does not recognize the deduction for qualifying contributions made to a Capital Construction Fund. Petitioner agreed, paid the tax, and for the deposit made by the Corporation

\$575,000.00. For federal tax purposes, the cost basis of the Vessel was the original cost (\$636,132.00) reduced by the qualified withdrawals from the Capital Construction Fund to partially fund construction of the Vessel (\$313,790.00), or \$322,342.00. The result being that the Corporation reported a gain of \$252,658.00 for federal income tax purposes which flowed through to Petitioners on their personal federal income tax returns. However, as Petitioners were denied the deduction for qualifying contributions made to the Capital Construction Fund in 2016 and 2017 for Louisiana income tax purposes, they reported a cost basis in the Vessel for Louisiana income tax purposes of \$636,132.00, which resulted in a loss of \$61,132.00 to the Corporation on the sale of the Vessel, which loss flowed through to the Petitioners as the shareholders of the Corporation. Petitioners attached a letter to their 2019 Louisiana personal income tax return explaining that they adjusted the basis in the Vessel upward from the basis as computed for federal income tax purposes to reflect the difference between the federal cost basis and the state cost basis for the Vessel.

Upon review of the 2019 Louisiana personal income tax return of the Petitioners, the Department disagreed with the computation of the basis of the Vessel by the Corporation, claiming that the Petitioners were bound to use the basis of the Vessel as computed for federal income tax purposes, and thus assessed Petitioners income tax, interest and penalties on that basis. Petitioners filed this appeal, seeking a

to the Capital Construction Fund in 2017, Petitioner did not reduce Louisiana taxable income by the amount of the deposit to the Capital Construction Fund.

redetermination of the assessment of income tax, interest, and penalties in the total amount of \$15,064.26 for the 2019 tax year bearing Letter ID: L0358331664 (the “Assessment”).

Discussion

The issue for our determination is whether basis of the Vessel for Louisiana income tax purposes is its total cost basis or whether the basis of the Vessel should be reduced by the qualified Capital Construction Fund withdrawals made by the Corporation to fund the construction of the Vessel. The Department argues that the Petitioners are bound by the federal AGI reported by the Corporation (computed with the reduced basis of the Vessel as required by IRC Section 7518(f)) and thus not allowed to adjust the basis of the Vessel (for Louisiana income tax purposes) upward for the qualified withdrawals from the Capital Construction Fund. The Petitioner argues that they should be allowed to adjust the federal tax basis in the Vessel upward by those amounts since, for Louisiana income tax purposes, they were denied the benefit of the reduction in income resulting from the qualified deposits made by the Corporation in 2016 and 2017 to the Capital Construction Fund. For the reasons that follow, we agree with the Petitioners.

Louisiana “piggy-backs” off of federal AGI under La. R.S. 47:293(1). That provision defines Louisiana AGI as the individual’s Federal GI that is “reportable” on their federal return. In *Boxill v. Louisiana Department of Revenue*, BTA Docket No. C0577A, 2020 WL 13379563 (La. Bd. Tax. App. 03/11/20), the Board stated:

Read carefully, however, La. R.S. 47:293 and 295 do not define Louisiana income literally as only the taxpayer's reported federal AGI. The express text of La. R.S. 47:293 defines "Adjusted gross income" as the adjusted gross income of the individual for the taxable year that is **"reportable," not the gross income reported** on the individual's federal income tax return. [emphasis in original]

As the Board also stated in Boxill, Louisiana retains the statutory definition of gross income in La. R.S. 47:42(A):

"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealing in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

As the quoted definition provides, gains from the sale of property are income. La. R.S. 47:131(A) sets forth the law on determination of gain or loss:

The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in R.S. 47:139 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

La. R.S. 47:139 provides: "The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under R.S. 47:140 through 47:155, adjusted as provided in R.S. 47:156." La. R.S. 47:140 provides: "The basis of property shall be the cost of such property, except as provided otherwise in 47:141 through 155." Nothing in La. R.S. 47:141 through 155 provides "otherwise" as applied to the facts of this

case (i.e., there is no adjustment to basis under Louisiana law for qualified withdrawals from a Capital Construction Fund).

The Department's position in this case ignores Louisiana's definition of basis. The Department points out that Louisiana has no provisions comparable to the federal Capital Construction Fund laws (i.e., there is no Louisiana income tax deferral for contributions made to a Capital Construction Fund). While that contention is correct, it ignores the logical corollary to that position, which is that there should be no adjustment to the basis of a vessel for Louisiana income tax purposes when qualifying withdrawals are made from the Capital Construction Fund to fund its construction. Using the cost basis of the Vessel as the Petitioners' basis in the Vessel, as required by La. R.S. 47:139, *et seq.*, leads to a determination that the Corporation (and thus the Petitioners) actually suffered a \$61,132.00 loss on the sale of the Vessel. If we were to adopt the Department's position in this case, the Petitioners would be taxed twice by Louisiana on the same income – first, by denying the deduction to the Corporation (and thus the Petitioners) on its qualifying deposits made to the Capital Construction Fund; and second, by the reduction in basis in the Vessel (and thus increase in the gain on its sale) for qualified withdrawals from the Capital Construction Fund on funds that were already taxed by Louisiana in prior years. The Department's adjustment to Petitioners' 2019 return is therefore contrary to the law.

Accordingly, Petitioners are entitled to the relief prayed for, and the Assessment must be canceled.

Baton Rouge, Louisiana, this 13th day of July, 2023.

FOR THE BOARD:



**Francis J. "Jay" Lobrano, Chairman
Louisiana Board of Tax Appeals**