

Minutes of the Meeting of the Public Participation  
Working Group on Business Income/Unitary Business  
Whitefish, Montana—August 6, 1997

**Preliminary Matters.** Co-Chair W. Val Oveson called the meeting to order. Co-Chair Stephen Auster participated by teleconference.<sup>1</sup> Attached exhibit “A” lists those persons who identified themselves as present at the meeting by voluntarily entering their names and other data on a sign-up sheet. Time was given for each person present in person or by teleconference to identify themselves by voice introduction, if that was their desire. There were no public comments.

**Report of Task Forces.** The meeting proceeded to receive a report from each of the three task forces, Task Force A, Task Force B, and Task Force C, that had been formed to examine specific issues raised by the drafts submitted to the PPWG.

**Report of Task Force A:** The task force reported on its deliberations as follows—

*Issue of Business Income Definition*

1. Two tests. The task force tentatively<sup>2</sup> agreed or reached a consensus that regardless of the statutory language of UDITPA, the definition of business income should be based on two independent tests that are generally embodied in the now commonly used concepts of the transactional test and the functional test. The terminology used to describe these tests might change, however. The task force will postpone to the time after agreement or consensus has been reached on the proper phrasing of the two tests to determine whether the tests as developed are actually supported by the statutory language of UDITPA. (After this report, a representative of business questioned whether it was accurate to state that there was an agreement or consensus within the task force on the need for two tests in determining business income.)
2. Transactional test language. The task force tentatively agreed or reached a consensus that the transactional test language found at

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<sup>1</sup>Following the receipt of a request by representatives of business, the PPWG elected to provide for participation in the meeting by teleconference. Although given an opportunity to express opposition to this participation by telephone, no one present at the meeting objected to providing this accommodation to business representatives.

<sup>2</sup>The reporting of an agreement or consensus of a task force should not be interpreted that the agreement or consensus was final even as to the persons who actually participated in the deliberations of the task force. The process of the PPWG does not contemplate a final agreement or consensus until all parts of the proposal are completed.

lines 55-69<sup>3</sup> was acceptable, although some expressed a concern that some terms like “frequent\*” might require a definition. The language of lines 69-74<sup>4</sup> was objected to by several participants. Specifically, the objection is to the reference to the type of business in which the taxpayer is engaged as opposed to the taxpayer’s own precise business. Some state representatives did not support elimination of the language.

3. Introductory and following language of functional test. The introductory language of the functional test at lines 75-78<sup>5</sup> was identified as needing revision. The introductory language should state the general principle of the functional test. The language that follows the statement of the general principle should then flesh out the principle in indicating what types of income come within the principle and what types of income fall outside the principle. One suggestion for changing the introductory language was,

(4) **Functional test.** Business income also includes income from tangible and intangible property if the property serves an operational function in the taxpayer’s regular trade or business.

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<sup>3</sup>The approved language reads,

“(3) **Transactional Test.** Business income includes income arising from transactions and activity in the regular course of the taxpayer’s trade or business.

(A) If the transaction or activity is in the regular course of the taxpayer’s trade or business, part of which trade or business is conducted within [this State], the resulting income of the transaction or activity is business income for [this State]. Income may be business income even though the actual transaction or activity that gives rise to the income does not occur in [this State].

(B) For a transaction or activity to be in the regular course of the taxpayer’s trade or business, the transaction or activity need not be one that frequently occurs in the trade or business, although most frequently occurring transactions or activities will be in the regular course of that trade or business.

<sup>4</sup>The disapproved language reads,

It is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does.

<sup>5</sup>The introductory language to the functional test presently reads,

(4) **Functional test.** Business income also includes income from tangible and intangible property, if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.

An expanded suggestion for revising the introductory language that also provided a more complete format for developing the language that is intended to follow the statement of the general principle was,

(4) **Functional test.** Business income also includes income from tangible and intangible property if the property from which the income is derived serves or has served an operational function in the taxpayer's regular trade or business.

A. *Income constituting business income under functional test.* Property serves an operational function when

i. [Analyze items (A) through (F), lines 79-136, for purposes of taking statements therefrom that will identify certain types of property as meeting the operational function requirement, e.g., "The property is or was an integral, functional, necessary, or operative component to the taxpayer's trade or business operations, part of which trade or business is or was conducted within this State."]

ii. ["The property is or was held in furtherance of the taxpayer's trade or business beyond mere financial betterment."]

iii. [Other possible instances from (A) through (F), lines 79-136, or from other considerations.]

B. *Income not constituting business income under functional test.* Property does not serve an operational function when

i. [Analyze items (A) through (F), lines 79-136, for purposes of taking statements that identify certain types of property as not meet the operational function requirement, e.g., "The property is or was held for mere financial betterment of the taxpayer in general."]

ii. [Other possible instances from (A) through (F), lines 79-136, or from other considerations.]

No consensus has been reached on how the revision might look. Some expressed concern that the statement of the general principle not negate the possibility of conversion of business property to non-business property and non-business property to business property.

#### *Issue of Diverse Businesses*

One Test. The task force tentatively agreed or reached a consensus that the test for determining whether diverse businesses were part of a unitary group should be the same as the test employed in determining whether other types of non-diverse businesses are a part of a single unitary group.

**Report of Task Force B:** The task force reported on its deliberations as follows—

*Issue of Presumptions*

The task force reported on six different presumptions or rules of evidence that could be analyzed as being in the nature of a presumption. The task force's reaction to each of these "presumptions" follows.

1. Presumption in favor of business income. The task force, subject to a reserved objection noted below, tentatively agreed or reached a consensus that there should be a presumption in favor of finding business income as long as the presumption would work both ways, *i.e.*, bind both taxpayers and States. The presumption would require a showing of clear and cogent evidence by the party seeking to overcome the presumption. The language of lines 50-54 would probably be revised to read something like,

(B) All income of the taxpayer is business income unless clearly classifiable as nonbusiness income. A taxpayer or [this State] seeking to overcome a classification of income as business income must establish by clear and cogent evidence that the income has been incorrectly classified.

The reserved objection noted above pertains to the use of the clear and cogent evidence standard as what is necessary to overcome a classification of business income. At least one representative of business indicates that the standard, although established in U.S. Supreme Court jurisprudence, is rarely used by state courts in rendering their decisions on business income.

2. Idle property. The task force discussed the principles apparently at work in MTC Reg. IV.1.(c).(1), *example (vii)* (lines 212-221)<sup>6</sup> and MTC Reg. IV.1.(c).(2), *example (v)* (lines 248-257)<sup>7</sup> that recognize

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<sup>6</sup>MTC Reg. IV.1.(c).(1), *example (vii)* (lines 212-221) reads,

The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The net rental income received over the lease period is nonbusiness income and the gain (or loss) on the sale of the building is nonbusiness income.

<sup>7</sup>MTC Reg. IV.1.(c).(2), *example (v)* (lines 248-257) reads,

The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an unrelated investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building

property previously classified as business property can become nonbusiness property. These examples reflect the general understanding that property sold following an abandonment from a business use for five years gives rise to nonbusiness income. See *also* the closely related property factor regulations at MTC Reg. IV.10.(b). While this rule, if stated as a general principle, was seen as workable, the task force did not reach consensus on possibly including a statement to this effect in the proposal.

3. Identifiable event. Some participants contended that an identifiable event can give rise to a reclassification of property as business property or nonbusiness property. The concept of an identifiable event giving rise to reclassification of property as business or nonbusiness is recognized in the existing regulations, reproduced at lines 227-230 of the proposal<sup>8</sup> and in the existing property factor regulations, the relevant portion of which is not included in the proposal.<sup>9</sup> The diseased turkey farm that was no longer useable for that purpose was one example of an identifiable event resulting in a reclassification of business property to nonbusiness property. While an identifiable event should work in both directions, the task force did not reach consensus on whether a more explicit statement should be made of possible conversion based upon the existence of an identifiable event.
4. Deductions or inclusion in property factor. The proposal at lines 115-120 contains a presumption that property is business property if deductions tied to the property are taken or the property is included in the property factor.<sup>10</sup> The task force did not reach consensus on the inclusion of this statement.

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at a gain (or loss). The gain (or loss) on the sale is nonbusiness income and the rental income received over the lease period is nonbusiness income.

<sup>8</sup>The business income portion of the existing regulations at MTC Reg. IV.1.(c).(2) that are reproduced in the proposal at lines 227-230 in part state,

However, if the property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. See Regulation IV.10.

<sup>9</sup>The property factor portion of the existing regulations at MTC Reg. IV.10(b) in part states,

Property used in the regular course of the trade or business of the taxpayer shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of nonbusiness income, its sale, or the lapse of an extended period of time (normally, five years) during which the property is held for sale.

<sup>10</sup>Lines 115-120 read,

5. Regular course of trade or business. The proposal at lines 69-74 contains an evidentiary statement that regular course of a trade or business can be defined by reference not only to the taxpayer's specific business but also to the general type of business in which the taxpayer is engaged.<sup>11</sup> The task force has not reached consensus on the inclusion of this statement.
6. Property first acquired. A related presumption that was identified while Task Force B made its report was whether property when first acquired should be presumed to be business property. Ensuing discussion by the PPWG led to no consensus on the issue.

*Issue of Instant Unity*

1. Acquired companies. The task force tentatively agreed or reached a consensus, subject to at least one business representative's continuing objection to the use of the clear and cogent evidence standard described above, that the proposal should contain a presumption *against* instant unity in the event of a corporate acquisition. The presumption against instant unity would operate for the short reporting period (from date of acquisition to date immediately preceding the group's first full common tax reporting period). However, either the taxpayer or the State can challenge the presumption against instant unity based upon facts and circumstance that establish the existence of unity by clear and cogent evidence. Upon such proof, unity would be presumed to exist for the entire period unless the opposing party established by clear and cogent evidence that the unitary relationship existed at a different point in time.
2. Similarly the task force tentatively agreed or reached a consensus, subject to at least one business representative's continuing objection to the use of the clear and cogent evidence standard described above, that the proposal should contain a presumption *favoring* instant unity in the event of the formation of a new corporation. The presumption favoring instant unity would operate for the short

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(E) If with respect to an item of property a taxpayer (i) takes a deduction from business income that is apportioned to [this State] or (ii) includes the original cost in the property factor, it is presumed that the item or property is or was integral to the taxpayer's trade or business operations. No presumption arises from the absence of any of these actions.

<sup>11</sup>Lines 69-74 read,

It is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does.

reporting period (from date of formation to the date immediately preceding the group's first full common tax reporting period). However, either the taxpayer or the State can challenge the presumption favoring instant unity based upon facts and circumstance that establish the non-existence of unity by clear and cogent evidence. Upon such proof, non-unity would be presumed to exist for the entire period unless the opposing party established by clear and cogent evidence that the unitary relationship did not exist at a different point in time.

#### *Issue of Unity of Ownership*

The task force reported no consensus on the issue of unity of ownership. The California statute §25105 and Legal Ruling 91-1 were identified as a possible paradigm for developing unity of ownership principles in the proposal. One participant suggests abandoning the element of control in the unity of ownership analysis. The justification for this approach is that unitary of ownership only fulfills a fairness rule of being able to attribute the income of an affiliated company to another affiliate or an affiliated group acting in concert. The participant explained that control is an element for determining whether there is a unitary relationship at all, not whether there is unity of ownership. So the rule as would be stated by this participant was, "Unity of ownership exists if there is direct or indirect ownership of more than 50% of the voting stock of the business entity by another entity or a group acting in concert." The task force reported that it was not prepared to embrace the initiative described above but committed to reflecting on the proposal in light of paradigmatic § 25105 and Legal Ruling 91-1.

#### *Issue of Holding Companies*

The task force tentatively agreed or reached a consensus that the proposal should contain a statement on the combination of passive holding companies, whether parent or intermediary, at least similar to what the California Franchise Tax Board has reflected in its Legal Rulings 95-7 and 95-8. Beyond this conclusion the task force reported no agreement or consensus. The myriad of issues flowing from a holding company with respect to more than a single unitary business, *i.e.*, holding company over two or more separate unitary businesses, remains unresolved within the task force.

#### *Issue of Pass-Through Entities*

The task force reported that it was close to embracing the idea that the proposal should include the approach of the California regulation

on the combination of partnerships. See Cal Reg. § 25137-1. One task force member mused aloud during this part of the report that perhaps things should settle down some, given the increased proliferation of pass-through entities and the issues that are now on the table, e.g., check-the-box, before running to embrace a regulation that may turn out to be counter-productive. However that musing might impact the reported momentum of the task force on the partnership combination issue, the task force was clear that that it would not attempt to deal with the combination of pass-through entities outside of partnerships.

**Report of Task Force C:** The task force reported on its deliberations as follows—

*Issue of Determining Scope of Unitary Business*

At the initiative of John Warren, the task force is examining the feasibility of the proposal emphasizing the “basic test,” i.e., centralization of management, economies of scale, and functional integration, and de-emphasizing the other two acknowledged test, three unities and contribution/dependency. This approach would not relegate the two other acknowledged tests to the dust bin as relics of the past, but would only emphasize the “basic test” as the most useful to securing a meaningful analytical discipline to make the necessary determination of the scope of a unitary business. The task force has not completed its examination on whether this approach makes more sense than giving equal emphasis to the two other tests, as the proposal currently does. The task force does appear to prefer to rename the “Mobil test” of the proposal the “basic test” or something of that ilk.

*Issue of Consistency of Business Income Principle with Property Factor*

The task force has also looked at the issue of whether there is an inconsistency in the application of principles over the inclusion of property in the property factor and the generation of business income. Specifically, the task force has looked at existing MTC property factor regulations IV.10.(a). that appear to recognize a pro rata principle.<sup>12</sup> And the task force has then compared this pro rata principle with the apparent predominant use principle operating in the existing MTC

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<sup>12</sup>MTC regs. IV.10.(a). in part state,

Property used both in the regular course of the taxpayer's trade or business and in the production of nonbusiness income shall be included in the factor only to the extent that the property is used in the regular course of the taxpayer's trade or business.

business income regulation at IV.1.(c)., *examples (iii) and (v)*.<sup>13</sup> The task force has reached no consensus as to whether the principles are conflicting or how the conflict, if it exists, should be resolved.

*Issue of Removal of Property from Property Factor*

The task force has looked at the rules as to when property is removed from the property factor. The text of the business income proposal at lines 96-98 has raised this issue.<sup>14</sup> Tentative agreement or consensus has developed to delete lines 96-98, but with the understanding that the deletion would not give rise to any inference from the deletion—the absence of the language would not suggest whether the described income was business or nonbusiness income.

The task force also tentatively agreed or reached consensus that the five years of idleness rule works in determining whether business property has converted to nonbusiness property.

*Issue of Defining Nonbusiness Income Instead of Business Income*

The task force has not reached any conclusion on whether defining business income is preferred to defining nonbusiness income. The task force will not analyze that approach until it receives a specific propos-

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<sup>13</sup>MTC Reg. IV.1.(c). at examples (iii) and (v) state,

*Example (iii):* The taxpayer operates a multistate chain of men's clothing stores. The taxpayer purchases a five-story office building for use in connection with its trade or business. It uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are leased to others. The rental of the two floors is incidental to the operation of the taxpayer's trade or business. The rental income is business income.

*Example (v):* The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in a 20-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business income of the clothing store trade or business. Therefore, the net rental income is nonbusiness income.

<sup>14</sup>Lines 96-98 (the lines being underlined) read in context,

Income from the licensing of an intangible asset, such as a patent, copyright, trademark, service mark, know-how, trade secrets, or the like, that was developed or acquired for use by the taxpayer in its trade or business operations, constitutes business income whether or not the licensing itself constituted the operation of a trade or business, and whether or not the taxpayer remains in the same trade or business from or for which the intangible asset was developed or acquired.

al suggesting how this might be done. This issue still remains contingently under examination by the task force.

**Open Discussion of Task Force Reports.** The three task force reports then were openly discussed.

**Task Force A:** The open discussion of the report of Task Force A, to the extent it raised new matters, contained the following matters—

*Issue of Business Income Definition*

One questioned as a constitutional matter following the decision in *Allied-Signal* whether there still was the so-called functional test. Others challenged this proposition by noting that the functional test was no more than recognition that income from property used in the unitary business gave rise to income that could be constitutionally apportioned.

Some allowed that the proposed regulation did not sufficiently recognize the possibility of nonbusiness income, especially in the functional test part of the regulation. This comment was rejoined with the request that those feeling the proposal did not sufficiently acknowledge the possibility of nonbusiness income were challenged to suggest language that would cure the alleged deficiency. The proponents of having the proposal recognize more possibility of nonbusiness income wanted to work from revised language developed by the MTC staff.

When the expanded language noted above under the Task Force A report under the topic, *Introductory and following language of functional test*, was suggested as a starting point to develop alternative language, a complaint was registered that the expanded language appeared to deny the possibility of conversion of business property to nonbusiness property by use of the phrase, “. . . has served an operational function . . .”. Others stated that the conversion issue was to be dealt in a separate provision and the statement of the expanded language would acknowledge the conversion principle in an appropriate way once that provision was developed. [**Ed. Note:** Persons wanting to propose language to reflect greater possibility of nonbusiness income should consider using the expanded language noted above for adding principles or examples of nonbusiness income or suggest an entirely different format with additional language, if the expanded language is unacceptable to them. Task Force A will consider these proposals at its next meeting.]

Lines 65-74 of the business income proposal<sup>15</sup> drew additional comments to those noted above in the task force report, *i.e.*, deletion in the second sentence of the reference to the type of business in which the taxpayer was engaged. There was a general question as to why the paragraph was needed at all, especially if the functional test remains. The response was that “regular” in the phrase “regular course of the taxpayer’s trade or business” did not necessarily mean frequently occurring. “Regular” also means normal without regard to frequency or intervals of occurrence. So if a transaction was a “normal” thing to do, even though the taxpayer did not engage in that type of transaction on a frequent or scheduled basis, the transaction could still be viewed as occurring the *regular course of the taxpayer’s trade or business*.

There was a suggestion that perhaps in defining “regular course of the taxpayer’s trade or business” reference could be made to the accounting profession’s concept of an extraordinary transaction or even the IRC’s “ordinary and necessary” concept in § 162.

**Task Force B:** The open discussion of the report of Task Force B, to the extent it raised new matters, contained the following matters—

*Issue of Clear and Cogent Evidence*

The request was made that those that are troubled by the use of the clear and cogent evidence standard to overcome presumptions in the area of business income develop their principled argument so that it will receive a hearing before Task Force B. [**Ed. Note:** Persons wanting to advance the argument that the clear and cogent evidence standard is inappropriate must describe in writing what their position reflects.]

*Issue of Unity of Ownership*

In connection with the issue of whether the concept of control should be a part of the unity of ownership principle, some urged that there at least be a recognition of concerted action for purposes of

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<sup>15</sup>Lines 65-74 read,

(B) For a transaction or activity to be in the regular course of the taxpayer’s trade or business, the transaction or activity need not be one that frequently occurs in the trade or business, although most frequently occurring transactions or activities will be in the regular course of that trade or business. It is sufficient to classify a transaction or activity as being in the regular course of a trade or business, if it is reasonable to conclude transactions of that type are customary in the kind of trade or business being conducted or are within the scope of what that kind of trade or business does.

satisfying unity of ownership. One business representative noted that Hawaii developed its ownership concept by reference to the principles of IRC § 269(b). This notation was greeted with the request that if Hawaii's regulation in this area was being offered as an approach to be considered, then something in writing needed to be submitted.

#### *Issue of Pass-Through Entities*

The division of among participants in Task Force B became more apparent in the open discussion. While there is strong sentiment for considering the California approach for partnerships to eliminate the existence of two different approaches that exist within the States,<sup>16</sup> there was also an expression of going slow in this area, given the dramatic amount of change that is occurring in tax treatment of pass-throughs.

There is of course a need to develop a proportion of the factors that flow through to the corporate partner under the California approach. One participant volunteered to submit something on this issue for the consideration of the task force.

#### *Issue of Passive Holding Companies*

The reserved issues arising from the includibility of passive holding companies were noted and appear to be among the most intensely contentious issues. These issues that primarily arise when the passive holding company acts with respect to more than a single unitary business include: (i) with what line(s) may the passive holding company be combined, (ii) how are the factors treated, (iii) how are inter-company dividends eliminated, and (iv) how is interest accounted for, tracing or apportionment based on the notion of fungibility.

#### *Issue of Presumptions*

The MTC regulations' apparent recognition of the five year idleness rule for conversion was questioned. Some thought one year was a better period of time to permit the conversion of business property to nonbusiness property. Others noted there might be circumstances where insisting on a five year rule would raise constitutional concerns. The example given was of the diseased turkey farm that ren-

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<sup>16</sup>California under Reg. § 25137-1 provides that there will be a pass through of the distributive share of partnership items, including apportionment factors, to the corporate partner and thereafter a determination of the issue of a unitary business at the partner level without reference to a minimum ownership threshold. Other States provide for apportionment at the partnership level before there is any passing through of the distributive shares.

dered the farm no longer useable as a turkey farm. If the disease occurred 4.5 years after the farm became idle and when the farm was being held for disposition as land to be developed, could the taxpayer still secure nonbusiness income treatment for gain resulting from the sale of the land before the end of five years?

A participant asked how the presumption of correctness that attaches to audit adjustments interacts with the other presumptions that were being developed. An example raising this issue was a case where the State makes an audit adjustment that provides for instant unity of an acquired company. This audit adjustment runs counter to the presumption against instant unity that can be overcome only upon a show of clear and cogent evidence. Does the general presumption (correctness) fall to the specific presumption (instant unity)? Do you integrate the two presumptions, *i.e.*, presume that the State has shown by clear and cogent evidence that instant unity is correct in this case but this presumption of correctness is overturned by a taxpayer showing that the State has failed to establish by clear and cogent evidence that instant unity is appropriate. Some indicated that the substantive presumption, *e.g.*, the presumption against instant unity, was an audit or administrative presumption and that there was not quite the conflict described with respect to the presumption of correctness that attaches to audit adjustments in the judicial setting. One participant did state that it is desirable to avoid inconsistent results arising from different presumptions.

**Task Force C:** The open discussion of the report of Task Force C, to the extent it raised new matters, contained the following matters—

*Issue of Emphasizing Basic Test*

The PPWG encouraged Task Force C to examine the desirability of emphasizing the basic test, *i.e.*, centralization of management, economies of scale and functional integration, over the two other recognized tests of three unities and contribution/dependency. Specifically, the PPWG wanted this examination to occur in the context of an overarching principle that provided an informed basis for knowing the meaning of the basic test's three analytical elements of centralization of management, economies of scale and functional integration. This overarching principle was identified as the flow of value concept of *Container*. [**Ed. Note:** See lines 83-97 of the unitary business proposal.]

When Task Force C reviews the economies of scale element to the basic test, one participant suggested that it determine whether econo-

mies should only be recognized if they pertained to line, as opposed to staff, functions. In response, a participant gave an example where a staff economy of scale might be significant. The example given was where one line of business cannot sell without product liability insurance that would not be practically available on a one line of business basis due to the small volume of business involved in that line. Would not this circumstance be one where a so-called staff function might give rise to significant economies of scale? Some else noted that *Mobil's* listing of operations giving rise to economies of scale seem to focus on staff functions, although perhaps later cases are more focused on line functions.

#### *Issue of Relating Expenses to Income*

One participant noted the need to focus on how to identify expenses that pertain to different types of income. Unless all income is apportionable in a taxing State, or all allocable in a taxing State, the taxing State must determine which expenses match income that is subject to tax. This problem is a generic one, a similar issue arising in the context of U.S. source income and foreign source income under the IRC. Treas. Reg. § 1.868-1 were proposed as a good source of inspiration as to how the States might be more specific than what is currently in the existing MTC regulations at IV.1.(d).<sup>17</sup> A participant handed out a general discussion of the issue.

#### *Issue of Consistency of Business Income Principle with Property Factor*

A participant, acknowledging the use of the pro rata rule for determining how much income is business income, indicated the complexity that can arise from making the necessary pro rata determinations year to year. Predominant use has simplicity to support its use.

#### *Issue of Defining Nonbusiness Income Instead of Business Income*

Although little support seemed present on whether there was any advantage to defining nonbusiness income, as opposed to leaving nonbusiness income to constitute anything that is not business income,

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<sup>17</sup>MTC Reg. IV.1.(d) in pertinent part provides,

**Reg. IV.1.(d). Proration of Deductions.** In most cases, an allowable deduction of a taxpayer will be applicable to only the business income arising from a particular trade or business or to a particular item of nonbusiness income. In some cases, an allowable deduction may be applicable to the business incomes of more than one trade or business and/or to several items of nonbusiness income. In such cases, the deduction shall be prorated among those trades or businesses and those items of nonbusiness income in a manner which fairly distributes the deduction among the classes of income to which it is applicable.

one participant who was responsible for raising the issue in the first place indicated that he would be submitting in writing how this construct might actually work.

**General Matters.** *Rewritten comments:* A representative from California wished the PPWG to understand that its July 30 letter was an attempt to be responsible for suggesting actual text, and not just comments. (This mode of operation is necessary if the PPWG is to complete its work in the scheduled one-year period.) The CA-FTB July 30 letter does contain some additional reflections due to the work of the PPWG that has occurred to date. A representative from Minnesota also indicated that that State would be rewriting its earlier submitted comments in same vein as had been completed by CA-FTB.

*Reflection:* The members of the PPWGs were encouraged to be reflective for the next three to four weeks on the work completed thus far. Hopefully, all materials will be able to be posted to the MTC Web page by that time.

*Next meeting of PPWG and task forces:* The PPWG will likely meet for a full-day on one of the following three days—28, 29 or 30 October 1997 in Washington, D.C. “Full day” means an ending soon after 3:00pm. [**Ed. Note:** The actual day for the meeting of the PPWG on Business Income/Unitary Business is Tuesday, October 28<sup>th</sup>, now tentatively scheduled from 9:30am to 3:00pm.]

The task forces will meet during the interim to consider unresolved issues and written materials that have been submitted by participants. [**Ed. Note:** Task Force C has determined that it desires to meet by teleconference on September 25<sup>th</sup> at 11:00am, Eastern Time, to consider John Warren’s restated unitary business proposal and any additional efforts in that same vein.]

## Exhibit "A"



## Sign-up

## Public Participation Working Group—Business Income/Unitary Business

Wednesday, August 6, 1997—Whitefish, MT

Name	Organization	Phone	E-mail
Alan Friedman	Cntr for Govt Dispute Resol'n	707-258-8082	alanf@napanet.net
Paull Mines	MTC	202-624-8699	pmines@mtc.gov
Kendall Houghton	COST	202-484-5215	kendallh@ix.netcom.
Karen Boucher	Arthur Andersen	414-283-3621	karenjboucher@arthu
Geoff Thorpe	Idaho Atty Gen	208-334-7539	
Dale Steager	WV Dept. Tax & Revenue	304-558-3356	
Duston Rose	Idaho State Tax Comm'n	208-334-7591	
Janette Lohman	Missouri DOR	573-751-7227	jloman@mail.state.m
W. Val Oveson	Utah State Tax Comm'n	801-297-3905	voveson@email.state
Roy E. Crawford	Brobeck <i>et al.</i>	415-442-1155	RCrawford@Brobeck
Jack L. Harper	NC DOR	919-733-8484	
Russ Uzes	Cooper & Lybrand	415-957-3593	russ.uzes@US.Coop
Gary Friesen	OR DOR	503-945-8648	
Mark Wainwright	UT Atty Gen.'s Office	801-366-0366	atdomain.atkey01.mv
George Mingledorf	AL DOR	334-242-1175	George.Mingledorff@
Natwar M. Gandhi	DC Office of Tax & Revenue	202-727-6083	
Michael J. McIntyre	Wayne State University	313-577-3944	mikemci@home.mse
Dave Metzler	MO DOR	573-751-4816	DMETZLER@SERV
Richard Oxandale	KS DOR	785-296-2381	
Jennifer Hays	KY Revenue Cabinet	502-564-6843	jhays@mail.state.ky.
Kenton Ball	KY Revenue Cabinet	502-564-3112	
Tom Yamachika	Coopers & Lybrand	808-531-3417	Thomas.Yamachika@
Deborah Vogt	AK DOR	907-465-2300	Deborah_vogt@revel
Michael Mason	AL DOR	334-242-1182	michaelmason@alali
David McClunk	AK DOR	907-269-6625	
Richard Pomp	U. of Connecticut Law	860-570-5251	Rpomp@Law.ucon.e
Joyce Kinkead	AZ DOR	602-542-4542	
Sharon Seedall	AZ DOR	602-542-3572	
Frank Shaffer	NM Tax & Revenue	505-841-6310	
Jerry Goldberg	CA Franchise Tax Board	916-845-4543	Gerald_Goldberg@ft
Barry Weissman	ARCO	213-486-1440	BWEISSM@mail.arc
Brian Toman	CA FTB	916-845-3311	BRIAN_TOMAN@f
Marshall Stranburg	FL DOR	850-488-0712	
William Lunka	MN DOR	612-282-5747	william.lunka@state.
Philip Plant	KPMG Peat Marwick	415-951-7266	pplant@kpmg.com

<b>Name</b>	<b>Organization</b>	<b>Phone</b>	<b>E-Mail</b>
Arthur Rosen	ABA/McDermott, Will, Emery	212-547-5596	arosen@mwe.com
Alysse Grossman	McDermott, Will & Emery	212-547-5344	agrossman@mwe.coi
John Bischoff	Ernst & Young	732-906-3322	JOHN.BISCHOFF@
Merle Buff	American Express	212-640-3815	MERLE.BUFF@aex
Louise Calvert	IL DOR	312-814-3512	lcalvert@revenue.sta
Wood Miller	MO DOR	573-751-0961	
Joe Thomas	CT DOR	860-541-4501	
Kathleen Stewart	MN DOR	612-296-0554	Kathleen.Stewart@st
Wood Herren	Brodley, Avort, Rose & White	205-521-8505	KWH@BARW.com
Louis Mills	AL DOR	334-242-9800	
Chris Sherlock	AL DOR	334-242-9800	
Dan E . Schamaeling	AL DOR	334-242-9690	
Harold Aldinger	ND Tax Dept.	701-328-3653	
Robert Mood	MA DOR	617-621-5130	
Ben Morrison	LA DOR	504-925-7626	
Bob Chilton	Montana	406-444-3586	BCHILTON@MT.G