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VIA ELECTRONIC MAIL

TO: Steve Auster, International Paper
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CC: Michael Mazerov, Multistate Tax Commission

FROM: Kendall L. Houghton

DATE: May 3, 1997

RE: **List of Issues Raised at MTC Business/Government Dialogue Day Concerning Business Income Regulation**

In accordance with your request, I am submitting the list of Business Income Regulation issues I recorded at the November 20th session of the Business/Government Dialogue Day, hosted by the MTC. They include the following:

- Several participants felt that the draft regulation would benefit from the inclusion of concrete examples, applying the principles and/or rules laid out in the draft regulation to different sets of facts and circumstances. [Of course, at least one state representative responded by stating that examples were too limiting, or not permitted in state regulations. My own thought on this is that if a State cannot incorporate examples into its own regulation, then it can adopt the regulation in modified form, once the MTC puts it forth.]

- There was some concern expressed as to the somewhat intertwined nature of the separate unitary business definition regulation and the business income regulation; I am not sure where the group came out on this, *i.e.*, did they want to merge the two regulations?

- Waivers: it was questioned whether taxpayers should be permitted, under the regulation, to make an election to waive its right to treat income as allocable, nonbusiness income (analogizing to the Kansas legislative fix to *Chief Industries*). The participants at Bus/Gov Dialogue appeared to believe that a waiver/election was appropriate, according to my notes.

- Changing Classification of Property Held by a Taxpayer: Two different tests/approaches were suggested to confront the fact that the character of property — as either business or nonbusiness investment property — can change over the time during which it is held.

  APPROACH 1: Divide the gain on disposition of the asset into two baskets: (a) allocable and (b) apportionable. The baskets hinge on determining the point of conversion (in character of asset); but, do you then need to find out if there was built-in gain/loss on that date?

APPROACH 1: Determine whether the predominant use was for business or for nonbusiness investment purposes, and then allocate or apportion 100% in accordance with that determination.

One participant noted that depreciation and other related expense recapture should be subject to the chosen approach, as well.

- Pass-through entities: If you can even establish unity with a pass-through entity (*e.g.*, LLC, LLP, partnership), then at what level is the business/nonbusiness income determination made, with respect to assets disposed of by the pass-through entity? The draft regulation does not address whether a flow-through/partner-level or entity-level determination is to be made.

I hope my notes are of assistance to you.

cc: William McArthur
Doug Lindholm