To: Michael Mazerov, Multistate Tax Commission

From: Frank Shaffer, New Mexico Taxation & Revenue Dept.

Re: Comments on Definition of Business/Non-business Income

Date: May 30, 1997

The Regulations recognize income of an asset based on the classification of the asset at the time the income is recognized. If the asset is a business asset the income from the asset is business income and if the asset is a non-business asset the income from the asset is non-business income. MTC Regulation examples IV.1.(c)(1)(vii) & IV.1.(c)(2)(v.) describe an office building that was converted to non-business property, where by, the gain on sale would be non-business income. My concern is that the Regulation does not address unrecognized income from an asset when the function of the asset changes.

My understanding of the regulation would allow a company to occupy, for 25 years, an office building that its owns and after converting the building to rental property (investment property) 100% of the gain on sale would be non-business income. This does not seem right. While the company used the building as its office building, depreciation would be applied against business income to the point that the book value of the building could be relative small compared to the market value at the time it is converted to investment property. The company could have a large unrecognized gain (market value in excess of book value) on the property that occurred while the property was being used as business property. The unrecognized business gain could then be classified as a non-business gain when the property is converted to investment property. Should not a portion of the gain be business income and a portion be non-business income?

If numbers are applied to the above scenario the consequence is more easily seen.

Original Cost	$20,000,000.
Net Book Value	4,000,000.
Market Value at conversion	25,000,000.
Sales Price	27,000,000.
Gain on Sale	23,000,000.
Business Income portion	21,000,000.
Non-Business Income portion	2,000,000.