



MEMORANDUM

TO: Wood Miller
Uniformity Committee
Multistate Tax Commission

FROM: Jennifer C. Hays
UDITPA Section 1 Work Group

DATE: July 20, 2015

SUBJECT: Report of the UDITPA Section 1 Work Group

The purpose of this memo is to update the Uniformity Committee as to the status of the work done to date by the UDITPA Section 1 regulation drafting work group. In addition, the memo raises questions for the Committee's consideration regarding the work to be done going forward and suggests issues that should be addressed during that work.

MTC staff has prepared both a red-line and a clean version for the Uniformity Committee's consideration of revisions made to date by the Section 1 Work Group, which are submitted with this memo. Within the red-line version, comments are placed in key positions throughout the document to explain some of the revisions made and to point to specific issues of concern for future consideration.

The Work Group began in November 2014, by analyzing whether the substitution of the terms "apportionable income," "non-apportionable income," and "receipts" is appropriate for the terms "business income," "nonbusiness income," and "sales." In most cases where these terms were used, the Work Group has made the substitution within the Section 1 regulations. It was at this initial point of reviewing the Section 1 regulations that the Work Group realized that the scope of work should logically move beyond revising the Section 1 definitional regulations. The terms "business," "nonbusiness," and "sales" are used throughout the entire range of the apportionment regulations. The Work Group recommends that the terms "apportionable," "non-apportionable" and "receipts" be substituted throughout the entire range of the apportionment regulations, with a

placeholder for the work of the Section 17 Work Group at the appropriate place within the range.¹

The Work Group then focused on how the term “business” was used, noting that the word could mean the taxpayer (a business), an activity (business done), or a description of an object (a business asset). Without increasing the number of definitions throughout the range of regulations, confusion could exist related to these terms when the statute deviates from the use of “business” and “nonbusiness” income. The Work Group is attempting to eliminate that confusion by minimizing the use of the word “business” in isolation, unless the word is used within a defined term; i.e., business activity or the trade or business.

The third phase of work proceeded by reviewing language and the various examples provided within the range of regulations to ensure that the transactional and functional tests were used to apportion income, but only the transactional test is used for the sourcing of receipts. When viewing the red-line version of the draft regulations, the majority of changes reflected in the document are related to this area of review. The Work Group requests that these revisions be your primary focus for discussion at the Uniformity Committee meeting.

Below are the major areas within the draft regulations still under consideration by the Work Group.

1. Should the five-year rule for transitioning property from apportionable to non-apportionable income be maintained considering the statutory change?
2. Should certain reserved language within the **Determination of a Unitary Business** portion of the regulations be maintained considering the passive holding company regulation has not been promulgated?
3. Should the draft regulations include lists of income which are or are not receipts?
4. Is it appropriate for the Section 18 language to be removed at this time, pending new Section 18 regulations to reflect the changes to market based sourcing in Section 17, as well as the elimination of the functional test for receipts?
5. Are additional definitions required; i.e., “hedging,” “securities,” “non-apportionable receipts,” etc.?

In addition to these items, the Section 1 Work Group is extremely aware of the need for coordination of language with the Section 17 Work Group. At this time, a placeholder has been created but the Work Group recognizes that additional regulations may well be necessary to reflect the sourcing changes being drafted in Section 17.

Finally, the Section 1 Work Group envisions an entire reorganization of the full range of regulations to ensure a cohesive, flowing document. For example, as currently organized the rather lengthy unitary business regulations interrupt the flow from the definition of receipts to examples of receipts in various contexts. It may be more logical for the examples to immediately follow the definitions.

¹ One caveat. There are a number of instances throughout the regulations where the term “sale” is meant to refer to a sales transaction. In such instances, the term “sale” should be retained.

The Work Group will reconvene following the Multistate Tax Commission Annual Meeting to address the following:

- A. A review of the use of the term “gross receipts” throughout the range;
- B. A review of the use of the term “trade or business” throughout the range; and
- C. Drafting regulations to resolve the questions listed above.

The Work Group acknowledges that revisions to the special industry regulations have not yet begun. The Work Group recommends that the Uniformity Committee either appoint a Work Group to begin that process or to expand the scope of the Section 1 Work Group to draft special industry regulations.

Finally, as chair of the Work Group I want to acknowledge the hard work of the staff from Arkansas, Idaho, North Dakota, and Oregon in participating on the Work Group. Over the past months, the work group has held almost- weekly teleconferences to discuss revisions to the UDITPA Section 1 regulations. The suggestions of the Work Group members have been thoughtful and of great value to the Work Group.