



MINUTES
Income and Franchise Tax Uniformity Subcommittee
Telephonic Meeting
Tuesday, October 19, 2010
3:30 pm – 5:00 p.m. EDT

I. Welcome and Introductions:

Chairman Robynn Wilson convened the meeting at 1:30 p.m. EDT and took a roll call of the persons in attendance:

Name:	Organization:	Name:	Organization:
Benjamin Miller Melissa Potter	California FTA	Gary Humphrey Katie Holly	Oregon DOR
Lennie Collins	North Carolina DOR	Louie Gomez	New Mexico
Lee Berlocher	Montana	Joe Garrett	Alabama DOR
Richard Cram	Kansas	Todd Lard	COST
Wood Miller	Missouri DOR	Karen Nakamura	PWC
Todd Lard	COST	Stewart Binke	Michigan DOR
Lee Berlocher Brenda Gilmer	Montana DOR	Diann Smith Beth Friedman	Southerland Law Firm
Kelly O’Connell	Idaho Tax. Comm.	Shirley Sicilian Sheldon Laskin Bruce Fort Ken Beier (phone)	MTC

II. Public Comment Period:

There were no comments from members of the public at this time.

III. Project Regarding Income Earned by Non-Corporate Income Taxpayers Derived From an Ownership Interest in a Partnership or LLC:

Chairman Wilson asked Sheldon Laskin, MTC Counsel, to inform the subcommittee on the status of efforts made by the drafting group. Referencing an October 5, 2010 cover memo, Mr. Laskin explained that the drafting group had previously proposed language limiting the proposed statute’s effects to income derived from active trades and businesses earned by pass-through entities. At the subcommittee’s December 2009 meeting, the working group was instructed to determine whether the

“active trade or business” standard was appropriately defined and administrable. Later, the phrase of “business income” was suggested as a means of distinguishing between active operations of pass-through entities and passive investments by non-corporate taxpayers. Mr. Laskin explained that the drafting group now recommends it was inappropriate to use the “business income” approach since that apportionment term would unduly complicate the proposed statute’s scope of operation. Referencing IRC Section 162 encompasses the “trade or business” standard used by the federal tax system.

Mr. Laskin pointed out the second change, which was an explicit inclusion of REITs as pass-through entities subject to the statute’s requirements that income be recognized at the entity level.

Mr. Laskin pointed out that two proposed models were before the subcommittee. The first alternative provides that where an insurance company or other entity not subject to corporate tax owns 50% of a pass-through, the pass-through would be required to recognize the income at the entity level. The second alternative would require the states to explicitly list those types of entities whose ownership interest would trigger the recognition requirement.

Karen Boucher stated that the statute is unclear in its application to banks and other financial institutions which are often subject to net worth taxes in lieu of income taxes, as well as alternative minimum taxes. While the subcommittee had explored the application of the statute to the insurance industry, it has not adequately considered the implications of the proposed statute for the banking and financial industry, and especially the possibility of double-taxation of income. Ms. Sicilian noted that option 2 would not automatically include banks or other entities that are not subject to income tax and not explicitly excluded. Under option 2, each state would list the entities and tax statutes that it has determined should be included under the model. To the extent banks should not be included in a particular state, as Ms. Boucher suggests, then the state would not list them.

Wood Miller (Mo.) asked for clarification of the treatment of REITs as taxable or disregarded entities. Mr. Laskin responded that they would be taxed as partnerships, not disregarded.

Gary Humphrey (Or.) asked why the drafting group had decided to limit the statute’s operations to entities owned 50% or more by a non-income taxpayer. Mr. Laskin explained that the limitation was intended to limit the statute’s operations to ownership of active trades or businesses, and the 50% limitation would exclude most passive investments from the statute’s operation.

Ben Miller (Cal. FTB) moved to approve Alternative Draft 2 for recommendation to the full Uniformity Committee. A voice vote was held with unanimous approval given by the subcommittee members in attendance.

IV. Project to Amend Compact Art. IV, Section 17 (Apportionment of Income from Sales other Than Sales of Tangible Property):

Shirley Sicilian, MTC General Counsel, summarized the draft and an October 8, 2010 memorandum that lays out three additional policy questions for the subcommittee. The first question is whether the proposed amendment should include explicit statutory authority for the tax commissioner to promulgate regulations effectuating the statute's sourcing rules. The second question is whether the inclusion of authority to make "reasonable approximations" of the place where a service is delivered or property used should be limited to subsection c, eliminated entirely from the statute to be handled by regulation, or added to subsections a and b of the statute. The third question is how to source receipts from sale or license of intangible property. Ms. Sicilian explained that this third question is best addressed in two parts: first, sourcing receipts from transactions in the ordinary course of its business, such as sales from inventory; and second, sourcing receipts from the sale or license of intangibles assets that are or were used in the taxpayer's business, such as patents. Ms. Sicilian suggested it would be helpful if the Subcommittee could make it through the first two questions, and begin discussing the third, during this teleconference.

The Chair then asked the Subcommittee to consider the first of the three questions. Ben Miller (Cal. FTB) stated the new section 17 should include explicit regulatory authority. Under California case law, inclusion of such authority results in courts giving greater weight to subsequent regulations. Katie Holly (Or.) expressed concern that such language could backfire if a state decides against promulgating regulations pertaining to particular circumstances, electing to treat issues on an *ad hoc* basis. Applying the language in only one section could raise questions about how much weight to give regulations with respect to the other sections that don't include that language. The failure to adopt regulations might actually hurt the state's ability to impose policy choices when issues arise in audits or in response to revenue ruling requests. She also noted the draft language said "proscribe" when it should read: "prescribe".

The subcommittee then moved to the second question and discussed how and whether the "reasonably approximated" language should be incorporated into the statute. Gary Humphrey stated that the lawyers in his agency were concerned by the language, and especially that the phrase only appeared in subsection (c). Chairman Wilson (AK) agreed that the language should be in all three sections or put into a regulation. Several subcommittee members expressed approval for continuing the "reasonably approximated" language in the proposed amendment.

Chairman Wilson asked for a voice vote on both questions one and two. All subcommittee members voted to include the explicit regulatory authority in the amendment. All subcommittee members also gave voice vote approval to adding the "reasonable approximation language to subsections (a) and(b) of the amendment. Gary Humphrey (Or.) voted to abstain.

The subcommittee then turned its attention to how sales and licensing of intangible property should be treated under Section 17. Ms. Sicilian described the policy

issues for the Subcommittee, and noted the resolutions of those policy questions that have been reached in the Massachusetts regulations and the California draft regulations. Mellissa Potter (Cal. FTB) explained that California was currently working on such issues for its own statute, and is leaning towards following the Massachusetts approach. Ms. Sicilian suggested the Subcommittee review both Massachusetts and California approaches and indicated that an update of the California approach would be posted soon.

V. New Business:

Ms. Sicilian asked the participants to let her know whether their states plan to send representatives to the December 7th and 8th meeting of the Uniformity Committee in Atlanta, as the Commission must watch to see if attendance might be too low.

VI. Adjourn