Final Report of the Hearing Officers
regarding the
Proposed Definition of "Gross Receipts"

I. Summary of Recommendations

Hearing Officers Roxanne Bland and René Blocker, respectfully submit this third and final report to the MTC Executive Committee regarding the proposed definition of "gross receipts". After review and consideration of the comments received during the public hearing process on this uniformity proposal, the hearing officers recommend that the proposed definition of "gross receipts", as set forth beginning page three of this final report, be submitted for a MTC Bylaw 7 survey of the Member States.

This report is rather brief. The initial hearing report (attached hereto as *Exhibit A-1*) and the second report (*Exhibit A-2*) dealt with issues such as, the clarity of the definitional language, the rationale for the exclusion of particular items from the definition, the relationship of the proposed gross receipts definition to the sales factor provisions under distortion relief provisions of UDITPA §18, particularly, the provision dealing with "churning" of certain intangibles, the applicability of the proposed definition to intercompany transactions, *etc*. This final report provides a background and summary of the hearing process for this proposal, presents the results of the additional comment period and sets forth the hearing officers' recommendations and final version of the proposed definition of "gross receipts".

For the benefit of the members of the public reviewing this report, the hearing officers note that the final report is simply the first step in the uniformity proposal adoption process. The Executive Committee may accept, reject or modify the hearing officers' recommendations or take other action it deems appropriate. If the Executive Committee decides to refer a uniformity recommendation to the full Commission, it may authorize the conduct of a Bylaw 7 survey of the affected MTC Compact Member States.[1] If a majority of the surveyed affected Member States affirmatively indicate that they would consider the proposal for adoption in their respective States, the full Commission votes, at its next meeting following the survey, on whether to adopt the proposal as a Multistate Tax Commission uniformity recommendation to the States. Although a uniformity proposal may be adopted by the Commission, no State is required to adopt the recommended provision. Each State decides independently whether to

[1] MTC Bylaw 7(g) provides, in part: "Any recommendation for action submitted by the Executive Committee to the Commission relating to uniform or compatible tax laws, regulations or administrative practices, regardless of whether such matters required hearings, shall be circulated to the members by the Executive Director for not less than 30 days to determine if the affected members will consider adoption of the recommendation within their respective jurisdictions."

pursue adoption of an MTC recommendation through that State's individual administrative or legislative process.

II. Background and Discussion

The original draft of the proposed definition of gross receipts was developed by the MTC Uniformity Committee and referred to public hearing by the MTC Executive Committee. "Gross receipts" is the operative term in the definition of "sales" under UDITPA §1(g) and in the MTC regulatory provisions, which provide that "'sales' means all gross receipts of the taxpayer not allocated" under other provisions of UDITPA. The determination of items to be included as "gross receipts" becomes most important in applying the sales factor provisions of UDITPA §§15-17 and in interpreting the sales factor provisions under UDITPA §18. Currently, there is no statutory or regulatory definition of gross receipts, although MTC Reg. IV.15.(a)(1) provides some guidance. The Uniformity Committee drafted a definition in an effort to provide a uniform general rule for determining the items of income that should or should not be included within the scope of "gross receipts" for sales factor purposes.

Over the course of two public hearings and an additional public comment period,[2] the Uniformity Committee's original draft has been revised to address, for the most part, clarity concerns raised by quite a few of the participants in the hearing process. (See *Exhibit D* for side-by-side comparison of original and revised draft versions of proposed definition.) Most of the comments submitted during the hearing process suggested clarification of the language of the proposal. (See *Exhibits C-1 through C-12* for all written comments submitted during the public hearings on this uniformity proposal.) For the most part, the comments were in general support of the proposed definition, although one commentary noted explicit opposition to the proposal. In their first two reports, the hearing officers attempted to address comments received from State and industry participants and modified the language of the proposal accordingly. (See *Exhibits A-1, A-2*.) An additional public comment period was held primarily to receive comment on whether recent State court business income decisions might have an effect on the language and/or application of the proposed definition.

Following release of the Second Hearing Report in July 2000, the hearing officers concluded that it was appropriate to extend the public comment period on the proposed definition of gross receipts in light of decisions by the California and North Carolina Courts. Both courts separately ruled that monies received from a pension reversion, which, according to the proposed definition, are

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[2] The first public hearing was held May 8, 1998. The hearing officers' initial hearing report was submitted in November 1998. An "informal dialogue" on the proposed definition was held pursuant to a notice dated March 1, 1999, and a second public hearing was held in July 1999. A second hearing report was issued in July 2000. Additional public comment was sought during a 30-day public comment period from September 12, 2000 to October 13, 2000. See public notices for these hearings at Exhibits B-1 to B-4.

excluded from the definition of gross receipts but may nevertheless constitute business income, is not business income and therefore should be excluded from the taxpayer's apportionable tax base (*Hoechst-Celanese Corp. v. Franchise Tax Board*, No. C030702, December 3, 1999); (*Union Carbide Corp. v. Offerman*, No. 453A98-2, February 4, 2000). In addition, North Carolina's highest court ruled that litigation awards, which are specifically excluded from the proposed definition of gross receipts, constitute business income and should be included in the taxpayer's apportionable tax base (*Polaroid v. Offerman*, 349 N.C. 290, 507 S.E.2d 284 (1998), cert. denied, --- U.S. ---, 143 L. Ed. 2d 671 (1999)). Although these cases address the determination of the nature of an item as business or nonbusiness income, the Hearing Officers queried whether these, and decisions like them, could have any effect on the application of the proposed "gross receipts" definition, or vice-versa. These cases dealt with items specifically listed in the proposed definition as examples of items of income to be excluded from "gross receipts". Thus, the Hearing Officers requested additional written public comment on whether there was a potential for these decisions to affect the proposed definition, as well as comment on the proposed definition in general. See public notice at *Exhibit B-4*.)

During the additional public comment period, two State representatives submitted general comments regarding the proposal (see *Exhibits C-11, C-12)*, however, no comments were received addressing the question of the potential effects of recent court decisions regarding business and nonbusiness income. The hearing officers thought it important to inquire whether the interested public had any concerns about these cases in relation to the proposed definition. There very well may be little or no potential for these kinds of cases to impact the application of this definition of gross receipts or for this definition to affect the outcome of business/nonbusiness income cases. Presumably, the proposal's unambiguous explanation that exclusion of an item from gross receipts "is not determinative of its character as business or nonbusiness income" will be sufficient to prevent misinterpretation of the intent that the definition remain neutral on the issue of determining business or nonbusiness income.

Recommendation

The Hearing Officers recommend that the proposed definition of gross receipts as set forth below, be submitted to a Bylaw 7 survey of Member States, and further recommend that the Executive Committee approve same. The definition recommended for approval has not changed from the Revised Draft II that was the subject of the additional public comment. (See *Exhibit B-4*.) If adopted by the MTC, the "gross receipts" definition would be added as a new paragraph (5) under MTC. Reg. IV.2.(a). Definitions.

> "Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or

the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example:

1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument;
2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;
3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock;
4) damages and other amounts received as the result of litigation;
5) property acquired by an agent on behalf of another;
6) tax refunds and other tax benefit recoveries;
7) pension reversions;
8) contributions to capital (except for sales of securities by securities dealers);
9) income from forgiveness of indebtedness; or
10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.

Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

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Hearing Reports

Exhibit A-1: Initial Hearing Officer's Report, November 13, 1998

Exhibit A-2: Second Report of the Hearing Officers, July 2000

Multistate Tax Commission

Uniformity Committee
Uniformity Subcommittee—Income Tax

Proposed Definition of Gross Receipts
for Purposes of Determining the Sales Factor
for Apportionment of Multijurisdictional Income

Interim Hearing Officer's Report

November 13, 1998

I. Introduction.

By direction of the Multistate Tax Commission ("MTC") Executive Committee, the appointed hearing officers held a public hearing on May 8, 1998, 2:30 PM EDT at the Hall of the States Building, 444 North Capitol Street, N.W., Room 325, Washington, D.C. 20001. The purpose of the hearing was to gather public comment on the MTC proposed uniform definition of "gross receipts". René Y. Blocker, acted as the Hearing Officer, and Roxanne Bland participated as the Assistant Hearing Officer. Below is the Hearing Officers' Report and recommendations for future action.

II. Background.

The Hearing Officer described the MTC public hearing process for determining whether the Commission should adopt the proposed definition of "gross receipts". The MTC Uniformity Committee drafted a definition of "gross receipts" as a proposed amendment to the definitions section of MTC Reg. IV.2.(a). The term "gross receipts" is not currently defined in the Uniform Division for Income Tax Purposes Act (UDITPA) or in MTC regulations. The term appears in UDITPA at §1(g) under the definition of "sales" and becomes applicable in the MTC sales factor regulations under UDITPA §§15-17 and in various MTC regulatory provisions under UDITPA §18. The proposed definition reads as follows:

> "Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest

EXHIBIT A-1

Headquarters Office: 444 N. Capitol St., NW, Suite 425, Washington, DC 20001-1538

New York Audit Office: 25 W. 45th St., Suite 1206, New York, NY 10036-4902

Chicago Audit Office: 223 W. Jackson Blvd., Suite 912, Chicago, IL 60606-6908

Houston Audit Office: 15835 Park Ten Pl., Suite 104, Houston, TX 77084-5131

and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for basis or cost of goods sold or property sold. Gross receipts do not include such items as repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument, the gross principal amount received under a repurchase agreement or other transaction properly characterized as a loan, proceeds from issuance of the taxpayer's own stock or from sale of treasury stock, damages and other amounts received as the result of litigation, property acquired by a agent on behalf of another, tax refunds and other tax benefit recoveries, pension reversions, contributions to capital, or income from forgiveness of indebtedness. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.

III. Public Comment Period.
The hearing officer opened the forum for formal public comment. No formal public comments were offered.

IV. Discussion

Jeffrey Friedman, Committee on State Taxation (COST) noted that the proposed definition excludes from gross receipts the "repayment of principal" and "damages." He asked how the "damages" portion would work in a State that uses both the transactional and functional tests. The Hearing Officer responded that the rationale for excluding the term in the definition of gross receipts was that damages may stem from violations in more than one State, thereby rendering the payments difficult to source. Mr. Friedman suggested that the concept should not be discarded altogether, but noted that it is problematic to de-link the receipt of damages from business income. He further noted that the same is true for pension reversions. He suggested that the MTC Uniformity Committee revisit this question with the aim of developing adequate sourcing rules.

Mr. Friedman further commented that the phrase "use of property or capital", as it appears in the proposed definition, seems to be quite broad and asked for clarification of the intended meaning of the phrase.

Mr. William Luna, Quick & Reilly, questioned the treatment of damages received for inventory loss, and whether it should be treated as business income. The response was that because a taxpayer recovers damages from the sale of inventory, damages replace income that would otherwise have been claimed as business income. The damages might be difficult to source, but it would still be classified as business income.

Joan Watson, Tax Analysts, queried how excluded receipts would be accounted for, i.e., whether such receipts would be included in the preapportioned tax base. The difficulty, she noted, is that there would be no factors in the apportionment formula reflecting these receipts.

Mr. Luna queried why the Commission does not appear to be following rules suggested in prior hearings—i.e., that the term "gross receipts" does not include the return of one's own capital. The Hearing Officer responded that the draft definition was not intended to create conflict between sales of a taxpayer's securities, which constitute business income, and the return of a taxpayer's own capital. She agreed with the commentator that the exception should be made clear that sales by securities dealers are not excluded from the definition.

Mark Graber of the State of Alaska queried how the proposed definition would be applied to the oil and gas industry. He explained that when oil companies exchange inventory, there is no recognition of gain or loss when the oil is exchanged, as the swap is not the culmination of the earnings process. Any value differentials resulting from the exchange are treated as inventory adjustments, and any gain resulting from the exchange is not recorded until the commodity is sold to a third party. This practice is recognized in various provisions of the Internal Revenue Code, and the State of Alaska also recognizes the practice. Under the current proposed definition, any exchange would result in a gross receipt. The Hearing Officer replied that it might be appropriate to survey other oil and gas producing States to ascertain their views on this issue. A hearing observer noted that other industries may engage in similar practices, and therefore it might be helpful to include a general exception to the definition in these cases.

Lennie Collins of the State of North Carolina noted that certain types of non-taxable income, such as interest income earned from U.S. bonds, could be considered business income and therefore included in the denominator of an apportionment fraction. The Hearing Officer replied that this issue was not discussed by the MTC Uniformity Committee when developing the proposed definition. Mr. Collins suggested that the definition could include a clarification that it only applies to "taxable business income." Mr. Luna commented that if earned income is not taxable, then it should not be included in the apportionment factor. If the income is used in a manner that generates business income, then it should be included.

Mr. Collins also queried whether the proposed definition excludes accounts receivables that have been bundled and sold, and further, if the receivable is a bond, would the principal and income be included in the sales factor, or only the net gain. Mr. Friedman of COST commented that if a taxpayer has enough accounts receivables, they could be viewed as inventory. Therefore, there would be no reduction for basis and they should be included in gross receipts. Mr. Collins asked whether this is not similar to making a nonliquid asset liquid. Mr.

Friedman replied that almost all business assets are liquid, and only a very few are illiquid. The business practice is to sell accounts receivables as protection from default. Indeed, some businesses do nothing but buy and sell accounts receivables.

Mr. Friedman asked for a clarification on what is meant by "gross principal amount", and whether there is a difference between "net" and "gross" principal amounts. The Hearing Officer responded that no answer is available at the present time, and that she would have to refer to her notes from the Uniformity Committee discussions.

Mr. Luna noted that it might be better to leave out the modifier "gross" in "gross principal amount", because in some transactions, such as repurchase agreements, the principal may be paid back with a rebate. Using the term "gross" would eliminate the rebate as taxable income.

Pat Verscheden of the State of Kansas also asked how the MTC proposed definition of gross receipts would relate to the definition used by a State that imposes a gross receipts tax. Ms. Verscheden further raised a question with respect to the treatment of nontaxable income—whether taxpayers should link the year of the transaction with the IRC before including the income as gross receipts for sales factor purposes. Mr. Friedman opined that the linkage would not be between the IRC and the taxability of income, but whether the income is taxable by the State.

There was no further discussion. The Hearing Officer extended the public comment period for 60 days in order to poll States and receive additional written comments. She then read into the record written comments received from the State of Arizona (summarized below), and noted that the State of Colorado raised a similar issue that the proposed definition does not include short term investments by nonfinancial institutions.

V. Summary of Written Responses

State of New Mexico

> New Mexico pointed out that the last sentence in the definition (*"Exclusion of an item from the definition of 'gross receipts' is not determinative of its character as business or nonbusiness income")* is incompatible with the first sentence (*"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code"*). The State noted if that by regulation an item of

income is not by definition a "gross receipt", then States will have difficulty in a court making the argument that it is still business income.

New Mexico also indicated that it is not certain what issue the gross receipts definition is attempting to resolve, and will not likely adopt the measure until after other States have had litigation experience.

State of Alaska

The State of Alaska's written comments reflected the concerns raised by the State during the hearing. Specifically, Alaska is concerned that the draft definition could include exchanges of crude oil inventory in the sales factor. The State explained that oil and gas companies routinely engage in such exchanges to minimize the commodity's transportation costs, by allowing companies to obtain suitable crudes produced nearest to the refineries. Such exchanges usually include a cash differential representing the differences in the quality of the crude (as well as transportation costs). Various generally accepted accounting methods are used to account for such exchanges, the common characteristic of which is that the gain or loss for each exchange is not recognized until sold to outside parties. Until then, the exchanges and cash differentials are usually accounted for as inventory adjustments. To account for each exchange according to the definition would "significantly increase and inappropriately overstate the sales denominator." The State suggested that the gross receipts definition be clarified to "to convey the rule that exchanges of inventory of this nature do not generate gross receipts for sales factor purposes."

State of Kansas

The State of Kansas observed that as a general matter, the proposed definition is short on clarity. In addition, it was pointed out that the list of items not considered gross receipts is "long and fairly specific". The State queried whether the list would "cover short term investments in money market accounts and/or other types of securities that have not been invented yet." Kansas also questioned whether it is clear in the definition that gross receipts includes the gain, loss or interest income from types of transactions not included in gross receipts.

State of Arizona

The State of Arizona commented that the term "similar instruments", as it appears in the definition, could be misleading, as "taxpayers may believe that the term connotes only a debt instrument of some type." (*Gross receipts do not include such items as repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument...*). Arizona suggested that the term be expanded upon either by including additional definitions, or including the term in a separate sentence such as "Gross receipts do not include amounts realized as the result of short term investments or re-investments of principal in mutual fund accounts, money market accounts or similar instruments."

The State further commented that although it appears that the proposed definition would not preclude the application of MTC Regs. IV.15.(a)(1)(F)(2) or IV.18.(c) in modifying the gross receipts included in the sales factor, because the definition is fairly detailed and is adopted subsequent to a certain amount of controversy over the sales factor, some taxpayers may attempt to view the proposed definition as a definitive statement of what items of income are included in the sales factor.

State of Colorado

The State of Colorado requested the following addition to the proposed definition: "Gross receipts do not include such items as repayment.....of short term investments by non-financial institutions." (Underline added).

Robert Feinschrieber, Esq., and Margaret Kent, Esq.

Mr. Feinschreiber and Ms. Kent offered three comments: 1) as used in the definition, whether gross revenues and gross receipts are equivalent, and if not, how the terms differ; 2) whether gross amounts are "realized" to equate to the recognition of gain or loss, and how it should be accounted for when the two amounts differ; and 3) the reference to business income in the context of gross receipts is confusing and whether it would be better to apply the definition to all receipts, whether or not they are for business or nonbusiness purposes.

The Williams Companies, Oklahoma

David Wulf, The Williams Companies, offered four comments: 1) Change the first sentence to read *"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or from the use of property or capital (~~including~~ e.g., rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code.*

2) Change the second sentence to read *"Amounts realized on the sale or exchange of property are not reduced for ~~basis or cost of goods sold or property sold~~ the cost of goods sold or the basis of property sold."*

3) The third sentence of the definition (referencing exclusions from gross receipts) is too long. Mr. Wulf suggests numbering the list of items mentioned.

4) Mr. Wulf commented that the fourth sentence, *"Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income"*, has nothing to do with gross receipts and should be deleted.

Hearing Officer Recommendations

The Hearing Officers recommend that the proposed definition of gross receipts be redrafted in light of the written and oral comments received at the public hearing. Specifically, it is recommended that the Commission, through the Hearing Officers, engage in an informal dialogue with those who participated at the hearing, as well as those who submitted written comments, with the aim of crafting a definition that satisfies the concerns of States and taxpayers alike. It is further recommended that any redraft of the proposed definition of gross receipts proposed by the Hearing Officers be presented to the MTC Uniformity Committee at its March, 1999 meeting, provided that unless objected to by the ~~Uniformity Committee, the Executive Committee authorize the continuation of the~~ Public Hearing to consider the redrafted proposal, and to conduct a second public hearing in the spring of 1999.

In response to the concerns of industry and States who participated in the hearing process, the Hearing Officers present below a draft alternate proposal to the current definition that the Uniformity Committee may wish to use as a starting point for discussion:

> "'Gross receipts' are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or from the use of property or capital (e.g., rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts do not include such items as
>
> - repayment, maturity, or redemption of the principal of a loan. bond, certificate of deposit or similar instrument,
> - the principal amount received under a repurchase agreement or other transaction properly characterized as a loan,
> - proceeds from issuance of the taxpayer's own stock or from sale of treasury stock,
> - damages and other amounts received as the result of litigation, property acquired by a agent on behalf of another,
> - tax refunds and other tax benefit recoveries,

- pension reversions,
- contributions to capital (except for sales of securities by securities dealers),
- income from forgiveness of indebtedness, or
- amounts realized as the result of short term investments or re-investments of principal in mutual fund accounts, money market accounts or similar instruments."

Other issues that the Committee may wish to discuss include:

1. The development of adequate sourcing rules for the receipt of damages and pension reversions.

2. The question of how excluded receipts are to be accounted for in the tax base.

3. The treatment of certain exchanges of inventory, and how such exchanges should be treated for purposes of determining gross receipts.

4. Clarification of the term "gross principal amount" and whether there is a difference between "net" and "gross" principal amounts.

5. Whether the proposed definition excludes accounts receivables that have been bundled and sold. If the receivable is a bond, whether principal and income would be included in the sales factor, or only the net gain.

6. The appropriateness of the final sentence in the proposed definition when contrasted with the first sentence.

7. The relationship of the proposed definition of gross receipts to a definition in use by a State that imposes gross receipts taxes.

Report of the Hearing Officers
regarding the
Proposed Definition of "Gross Receipts"

Executive Summary

On July 8, 1999, a second public hearing was held on the revised draft of the proposed definition of gross receipts. The term "gross receipts" appears in UDITPA's sales factor provision, but the term itself is not defined. The MTC Uniformity Committee undertook to craft a definition for "gross receipts" as a possible Commission uniformity recommendation. The first hearing on the proposed definition led to the amended version that was the subject of the second hearing.

In the current revised draft (Revised Draft II), the Hearing Officers chose not to incorporate a number of amendments suggested by participants in the second public hearing because the Hearing Officers believe the issues addressed by the proposed amendments are covered in distortion relief provisions in MTC Regulations §IV.18. In addition, the Hearing Officers remind interested parties that the gross receipts definition does not stand on its own as a replacement for the definition of the "sales factor", but works in conjunction with the definition to determine what items of income should be included in the sales factor for purposes of income apportionment. The proposed definition does not go to the question of whether a receipt should be classified as business or nonbusiness income. That is an entirely different issue.

Several recent decisions by state supreme courts concerning the character of income received through litigation awards and pension reversions might have an impact on the proposed definition. Hence, the Hearing Officers have determined that it is appropriate to extend the comment period for an additional thirty days in order to receive public comments on the effect of these decisions on the proposed definition of gross receipts. Accordingly, the Hearing Officers propose to extend the written comment period to August 24, 2000. Once the responses have been reviewed, the Hearing Officers will issued a Final Report and make a recommendation on whether the uniformity recommendation process should continue.

Comments Received at Second Public Hearing

Under direction of the MTC Executive Committee, the hearing officers conducted a second public hearing regarding the proposed definition of gross receipts for purposes of determining the sales factor in apportionment formulae.

Participating in the hearing via teleconference or in person were:
René Y. Blocker, Hearing Officer
Roxanne Bland, Assistant Hearing Officer

Jason Lumia, Policy Research Associate
Fred Montgomery, Sara Lee Corporation
Helen Cushell, Arizona Department of Revenue
Jane Doyle, Arizona Department of Revenue
Pat Krantz, Arizona Department of Revenue
Shona McHugh, Montana Department of Revenue
George Farrell, Bureau of National Affairs Publishers

North Dakota representatives and the law firm of Baker & McKenzie forwarded written comments.

During the hearing, Ms. Blocker outlined the procedure for the adoption of the proposed definition by the Commission. She noted that a hearing report would be prepared as a result of this hearing, which will be submitted to the Executive Committee. The Committee will decide whether to move forward with considering adoption of the proposal, return the matter to the Uniformity Committee for further work, or modify the Hearing Officers' recommendations. If the Executive Committee decides to move forward, a survey of the States will be conducted in accordance with the requirements of MTC Bylaw 7. If the survey results indicate that a majority of the affected Compact Member States would consider adopting the proposed definition, the proposal will be submitted to the Commission for a vote on whether to adopt the proposed definition as an MTC uniformity recommendation to the States. If a majority of Compact States are in agreement, the definition will be adopted. Although a uniformity proposal may be adopted by the MTC, there is no requirement that the States adopt the recommended provision. Each State decides independently whether to pursue adoption of an MTC recommended provision through that State's individual administrative or legislative process.

Ms. Blocker opened the hearing for comment.

Ms. Doyle, (AZ) noted that the revised draft contains the term "marketable" in the first item not considered a gross receipt. She further noted that this term was not used in the original draft. The Hearing Officers responded that the reason for the change was to make certain that Item 1 included more than simply debt instruments.

The Hearing Officer read the written comments received from North Dakota. The first comment suggested that the sentence "Exclusion of an item from the definition of 'gross receipts is not determinative of its character as business or nonbusiness income", which appeared in the original draft but was deleted from the first revised draft, be restored to the proposed definition. Ms. McCue, (MT) agreed with the North Dakota suggestion that the sentence should be included in the draft. Ms. Doyle, (AZ) observed that Revised Draft #1 is not taking a stand on what is or is not business income; a taxpayer might be uncomfortable with the exclusion of an item of income from the factor, but that does not mean it is not business income. Fred Montgomery (Sara Lee Corp.) noted that it would not hurt to clarify that the exclusion of an item of income is not determinative of its character as business or nonbusiness income. If an adjustment is made in a taxpayer's gross receipts, then an adjustment also must be made in the factor.

North Dakota also queried the manner in which royalties, interest and dividend income would be assigned to the numerator if they are to be included in the "gross receipts" denominator. Fred Montgomery (Sara Lee Corp.) mused that the answer to the question might be to determine if any activities producing such income took place within the state. If the answer is yes, then the items of income should be included; if not, then the income should be thrown out of both the numerator and the denominator. The Hearing Officers agreed with Mr. Montgomery's assessment.

The Hearing Officers turned to the comments submitted by J. Pat Powers of Baker & McKenzie. Mr. Powers queries whether it is appropriate to exclude from the definition of gross receipts the return realized from investments in mutual funds. He notes that while it is clear that returns of principal should not be included in gross receipts with respect to loans, bonds, and certificates of deposits, the same rationale does not necessarily support the exclusion of investments in mutual funds, since mutual funds are not instruments according to the common meaning of the term. In addition, Mr. Powers queried whether this exclusion would apply to a taxpayer's holding of stock that is not issued by the taxpayer. Another concern voiced by Mr. Powers with respect to the first enumerated exclusion is that if it is directed at short term investments or reinvestments, it follows that long term investments and reinvestments are not excluded from gross receipts. If so, guidance is needed to distinguish between long- and short-term investments.

Mr. Powers' second comment concerned the question of why the term "marketable" is used to modify the term "instrument", asking whether this means the return of principal from all instruments are excluded from gross receipts, or whether the definition refers only to the return of principal from "marketable instruments."

Mr. Powers also requested guidance as to why the amounts realized on the sale or exchange or property are not reduced for the cost of goods sold or the basis of property sold (which he agrees with), but that the same is not true for investments in mutual funds. He notes that there appears to be no obvious reason why amounts realized from the sale of property should be treated differently than amounts realized from the use of property (i.e., the use of funds to generate income).

Ms. Doyle (AZ), responding to Mr. Powers' third comment, observed that the reason for the treatment of mutual funds as articulated in the draft definition is the ease of investing and re-investing the principal of such funds. Sales of tangible personal property, she noted is a different animal from sales of intangible property. She also pointed out that the fact that the definition makes no distinction between intangible property held for long or short periods underscores the need for the final sentence in the first draft of the definition ("Exclusion of an item from the definition of 'gross receipts' is not determinative of its character as business or nonbusiness income."). The impact of investments and reinvestments of mutual fund principal on the sales factor lends support for its exclusion from gross receipts because of the liquidity of such funds—it is almost like cash. With respect to tangible property, even if there is a high turnover in inventory, one is still tying up capital. This is not quite the same for intangibles. Fred Montgomery (Sara Lee Corp.) suggested that the definition might be more explicit regarding the addition of gain to gross receipts, but not principal.

Another question with respect to "churning" issue involves the question of how to treat losses; i.e., whether losses should be netted out. Mr. Montgomery suggested that the sentence preceding the numbered exclusions read: "Gross receipts even if business income, do not include gross proceeds, but do include the net gain or loss from items such as...". No one present at the hearing made any objection to this language. Mr. Montgomery also suggested that the language be revised to clarify that the definition only applies to a part of the sales factor regulation, and does not constitute the entire regulation; i.e., that other sections of the sales factor regulations are not affected by this definition of gross receipts.

No further comments were forthcoming. The Hearing Officers advised that they would discuss the suggested changes to Revised Draft I of the proposed definition of gross receipts and implement those changes considered appropriate. would be discussed. Copies of the draft (Revised Draft II) will be sent to today's hearing participants, as well as those who participated in the first hearing. Depending on the volume of the response, a third hearing may be scheduled. Otherwise, the Hearing Officers advised that the proposed draft, with Hearing Officer recommendations, would be forwarded to the MTC Executive Committee for approval.

Upon consideration of the oral comments heard at the second hearing, the Hearing Officers elected to clarify the sentence preceding the list of exclusions and the first articulated exclusion to read as follows:

> "Gross receipts, even if business income, do not include such items as, for example:

repayment, maturity, or redemption of the principal of a loan; bond; mutual fund; certificate of deposit or similar marketable instrument; or stock;"

The Hearing Officers chose to make this limited revision because the majority of concerns expressed by hearing participants and other commentators are addressed elsewhere in Section IV.18 of the MTC Regulations. The "churning" issue (which was the issue that caused the most concern and generated the most discussion), is addressed in the definition by the phrase "even if business income", and also in IV.18(4). The Hearing Officers further determined not to use Mr. Montgomery's alternate language "Gross receipts...do not include gross proceeds but do include the net gain or loss from...". This concern too, is addressed in Regulation IV.18(4). The regulation refers to gains and losses when determining the sales factor. To include "net gain or loss" language in the gross receipts definition could result in even more confusion because the gross receipts definition is a further refinement of the definition of the sales factor, not its replacement. Other concerns with respect to mutual funds and marketable instruments have been resolved by changing the structure of the language articulating the first exclusion. The Hearing Officers note that the proposed definition does not supercede or alter in any way Section IV.18, nor does the definition replace the definition of the "sales factor". The proposed definition will simply work in conjunction with Section IV.18 by defining a term that is used throughout the section but has not been previously defined.

The American Institute of Certified Public Accountants filed written comments on the proposed definition of gross receipts dated on October 11th 1999. In general, AICPA does not support the proposed definition because, according to AICPA, UDITPA itself and many UDITPA states require the inclusion of a taxpayer's total sales in the sales factor, and further defines "total sales" as gross receipts. The proposed definition limits the definition of sales to net receipts. Thus, absent statutory changes in UDITPA and the corresponding state statutes, the no state has the authority to adopt the regulation. Moreover, if the intent of the regulation is to curb distortion in the sales factor resulting from the inclusion of gross receipts, then the remedy to limit sales to net receipts is sanctioned by § 18 of UDITPA.

Specifically, AICPA points out that it is not clear from that portion of the definition identifying gross receipts ("amounts realized from the sale or exchange of property") what the phrase "exchange of property" is intended to represent. AICPA suggests a modification that conforms to the commonly cited definition of a sale for sales tax purposes ("the transfer of title or possession of property") which encompasses sales, leases and exchanges.

The Hearing Officers respond that the clause "sale or exchange" modifies the term property, and simply recognizes that property can be disposed of in such a manner as to produce income without monetary consideration.

AICPA also notes—using the example of interest earned from government bonds—that treatment of income exempt under the IRC but taxable by states appears to be excluded by the definition, while income taxable under the IRC but exempted by states is included in the definition, and hence in the sales factor, because the income is recognized for federal tax purposes even though it may not be subject to state income tax. AICPA suggests a modification to the definition that clarifies that only income included in the state tax base is used for purposes of determining the sales factor. It is also unclear, AICPA says, whether income or loss recognized for federal tax purposes but where no money or property is actually received is excluded from gross receipts.

The Hearing Officers remind commentators and other members of the public that the proposed definition is not intended to reach the issue of whether a given receipt constitutes business or nonbusiness income. Rather, the definition applies to gross receipts *qua* gross receipts, without reference to whether the receipt in question should be classified as business or nonbusiness income. If it is determined that a receipt is properly classified as business income, the definition tells us whether that item should be included in the sales factor for apportionment purposes. Since interest income on government obligations—whether the underlying obligation is issued by the United States, state or local governments—generally does not constitute business income, it is entirely allocable to the state of domicile or principal place of business and is not included in a taxpayer's apportionable tax base.

—On the specific exclusions from gross receipts, AICPA finds that it is not clear whether the list is all-inclusive or non-inclusive. It also queries why the specified items do not constitute gross receipts, and would like for the MTC to provide guidance. Examples of items that are specifically excluded should be provided. In addition, AICPA finds that the definition does not provide adequate distinctions between when to include the full sales price of an asset or just the income earned from that asset. AICPA further finds confusion in the final item listed ("10. amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code"). AICPA points out that the definition already provides that gross receipts are amounts recognized under the IRC; the inference is that income not recognized under the IRC is excluded. To include a specific listing of income not recognized under the IRC as excluded from gross receipts, is, in AICPA's view, "a redundancy that will only create more confusion."

Discussion

The term "gross receipts" is the operative phrase in the definition of "sales" in UDITPA §1(g) and in the MTC regulatory provisions of UDITPA. See, *e.g.*, MTC Reg.IV.15. The concept of gross receipts becomes applicable in UDITPA §§15-17 sales factor provisions and the complementary MTC regulations thereto, as well as in MTC regulations interpreting the sales factor under UDIPTA §18. Currently, there is neither a statutory nor a regulatory definition of "gross receipts."

The MTC Uniformity Committee drafted a definition of "gross receipts" in an effort to develop a uniform general rule regarding what should be included in the scope of that term. The proposed definition follows the general theme of Treas. Reg.§1.448-1T(f)(2)(iv), which defines gross receipts to include total sales and all amounts received for services, investment income (including interest, dividends, rents, royalties), but excludes repayment of a loan or similar instrument and gross receipts are not reduced by cost of goods or property sold.[1] The proposed definition also reflects the existing treatment of interest, dividends, rents, *etc.*, set forth in MTC Reg. §IV.15 & §IV.17 and is designed to account for nonrecognition transactions. Although the proposed "gross receipts" definition generally follows Treas. Reg. §1.448-1T(f)(2)(iv), it clearly differs from the federal provision by clarifying that "gross receipts" are not to be reduced for

[1] Treas. Reg. §1.448-1T(f)(2)(iv) provides as follows:

> Determination of gross receipts--(A) In general: The term "gross receipts" means gross receipts of the taxable year in which such receipts are properly recognized under the taxpayer's accounting method used in that taxable year (determined without regard to this section) for federal income tax purposes. For this purpose, gross receipts include total sales (net of returns and allowances) and all amounts received for services. In addition, gross receipts include any income from investments, and from incidental or outside sources. For example, gross receipts include interest (including original issue discount and tax-exempt interest within the meaning of section 103), dividends, rents, royalties, and annuities, regardless of whether such amounts are derived in the ordinary course of the taxpayer's trade of business. Gross receipts are not reduced by cost of goods sold or by the cost of property sold if such property is described in section 1221 (1), (3), (4) or (5). With respect to sales of capital assets as defined in section 1221, or sales of property described in 1221 (2) (relating to property used in a trade or business), gross receipts shall be reduced by the taxpayer's adjusted basis in such property. Gross receipts do not include the repayment of a loan or similar instrument (e.g., a repayment of the principal amount of a loan held by a commercial lender). Finally, gross receipts do not include amounts received by the taxpayer with respect to sales tax or other similar state and local taxes if, under the applicable state or local law, the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the tax to the taxing authority. If, in contrast, the tax is imposed on the taxpayer under the applicable law, then gross receipts shall include the amounts received that are allocable to the payment of such tax.

cost of goods or property sold in any circumstance (unless UDITPA §18 is applicable).[2]

In the Revised Draft II version of the proposed definition, the Hearing Officers have re-inserted language stating that the exclusion of an item is not determinative of its character as business or nonbusiness income. Commentators made arguments both in opposition to this language as addressing an issue that is irrelevant to the definition as well as in support of this language as necessary to clarify that the proposed definition is not to be used as an indicator of whether an item is business or nonbusiness income. It is true that the first sentence of the definition indicates that a gross receipt results from certain named transactions that produce business income. Even so, the Hearing Officers have observed that there is much confusion regarding the subordinate relationship of the proposed gross receipts definition to the definition of the sales factor. It was therefore determined that the clarifying language serves the purpose of making clear that the issue of whether a receipt is business or nonbusiness income is outside the scope of the gross receipts definition.

Effect of Proposed Definition on Section 18

Several hearing participants raised concerns about the interaction of the proposed definition of "gross receipts" with UDITPA Reg.IV.18, particularly IV.18.(c)(4), which includes in the sales factor only net gains from the short term investment and reinvestment of certain intangibles. As a standard UDIPTA regulation, the proposed definition would be subject to same superseding effect that Section 18 would have on other regulations. Indeed, the proposal as revised specifically states that it is not to be construed to modify, impair of supersede any provision of Section IV.18. Thus, for example, Reg.IV.18.(c)(4), regarding net gains from sales of certain intangibles, would supersede the proposed definition where the particular circumstances warrant that provision's application.[3]

Examples of Items Excluded under the Proposed Definition

The introductory language to the list of excluded items makes it clear the list is not intended to be exclusive, although it is designed to be fairly comprehensive. The Hearing Officers note that by the use of the clause "for example", the

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[2] Under Treas. Reg. §1.448-1T(f)(2)(iv), gross receipts from the sales of certain capital assets and other property used in a trade or business are reduced by the adjusted basis in the property.

[3] It was pointed out to the Hearing Officers that a financial arrangement known as a commodity "tax straddle" might cause concern with respect to including receipts in the sales factor. (The tax straddle is a rather complex transaction, however, it appears to involve the purchase by a taxpayer of both a short and a long term position in a commodity, *e.g.*, silver, and then the offsetting of a gain in one position with a loss in the other position. It seems that the use of tax straddles could have the effect of deferring federal income tax liability on capital gains for long periods of time.) The Hearing Officers believe that the potential distortion effect of these transactions can be addressed by using UDITPA's §18 distortion relief provisions.

language of the proposed definition already indicates that the list of exclusions from gross receipts is non-inclusive. The list is a list of *examples* only, and is expected to be used as a guide in determining which items should and should not be included in gross receipts. The specific examples of items listed reflects the rationale discussed by the Uniformity Committee for the need for a uniform definition. Because the word "sale" implies a commercial transaction between contracting parties in which there is an exchange of value between the parties, the concept of "gross receipts" should not include receipts from transactions in which there is no exchange of value in a commercial market. Thus, gross receipts should exclude items like tax benefit recoveries, forgiveness of debt, pension reversions, *etc*. Likewise, the principal amount received from repayment of a loan, for example, should be excluded from gross receipts because the principal represents simply the return of a sum of money not an exchange of value. In contrast, the interest amount from a loan, for example, reflects a transfer of value from the borrower in exchange for other value (the loan) from the lender.

The exclusion of litigation awards from gross receipts was the subject of significant discussion within the Uniformity Committee and was raised as an area of concern by several hearing commentators. Part of the reasoning behind excluding such awards is that litigation generally does not create a market, is not a sales transaction, in the case of torts, is not a transaction with a customer and often does not produce income.[4] Also, for some types of income, such as litigation awards, it is difficult to determine where that income should be sourced, hence, it is excluded from gross receipts, which would effect essentially the same result as a proportionate spread across the taxpayer's sales in all states.

Finally, Item 10 in the list of exclusions from gross receipts simply restates in the negative the clause "in which the income or loss is recognized...under the Internal Revenue Code." Thus, if an exchange of property is not recognized by the IRC then any income or losses from the same transaction cannot be designated as a gross receipt.

Other Items Potentially Affected by the Proposed Definition.

InterCompany Transactions. AICPA also notes the definition's reference to the Internal Revenue Code in identifying business income. It is not clear, AICPA says, "how the definition may be affected by intercompany transaction rules under Treas. Reg. §1.1502-13. Acknowledging that most states do not require intercompany transactions to be included in the sales factor, AICPA points out that this treatment may not be consistent with the regulations governing federal consolidated returns. Because the federal rules to determine income or loss

[4] The argument might be different if the discussants had had the benefit of the North Carolina Supreme Court decision in Polaroid v. Offerman, in which the court ruled that damages awarded the taxpayer for patent infringement constituted business income. See discussion below.

relating to intercompany transactions are determined on a separate entity basis, the definition of gross receipts as "gross amounts realized...in which the income or loss is recognized under the Internal Revenue Code" may result in the inclusion of intercompany transactions in the sales factor for state apportionment purposes.

The Hearing Officers point out that the first sentence of the proposal refers to "gross amounts realized...*in a transaction which produces business income*, in which the income or loss is recognized...under the Internal Revenue Code." Since in combined reporting states, intercompany transactions usually are eliminated from the sales factor because they are viewed as occurring within the unitary business, such transactions would not be considered ones which produce business income within the language of the proposed definition. Additionally, it does not appear that this definition of gross receipts would change how separate entity states currently treat intercompany transactions in the sales factor.

Also, the AICPA states that the federal regulations do not apply to intercompany transactions between foreign and domestic affiliates, because foreign affiliates are not included in a federal consolidated return. At the federal level, such transactions are treated as transactions between unrelated corporations. To comply with the federal regulations at the state level necessarily means that transactions with foreign affiliates would be included in the sales factor, but identical transactions with domestic affiliates are not. This results in discrimination against foreign commerce in contravention of the Commerce Clause of the U.S. Constitution. AICPA's solution is to modify the language "or would be recognized if the transaction were in the United States" to ensure that the regulations do not violate the Commerce Clause. Where combined reporting states are concerned, the potential Commerce Clause issue does not arise because intercompany transactions will be ignored. Single entity states continue to face this potential constitutional problem whether or not this proposed definition is adopted by those states.

One solution to the intercompany transaction issue raised by AICPA may be to specifically list these transactions as excluded from gross receipts. From a combined reporting state's perspective, this already occurs. The effect of excluding intercompany transactions in the proposed definition would relieve separate entity states of the problems that might arise for those states as a result of the federal rules. However, the rationale for excluding items from gross receipts, *i.e.*, gross receipts should not include transactions where there has been no exchange of value between parties in a commercial market, may not hold much weight when applied to intercompany transactions that separate entity states are willing to recognize. The better approach may be to consider utilizing the UDITPA Section 18 distortion relief provisions to address problems that might arise in separate entity states dealing with intercompany transactions.

Recommendations

The Hearing Officers offer for further consideration of the public a Revised Draft II version of the proposed "gross receipts" definition. The major change in this draft has been the addition of a sentence in the last paragraph of the proposal clarifying that the definition is not intended to affect the determination of business or nonbusiness income. The proposed definition, if adopted, would amend MTC Reg.IV.2(a). Definitions, by adding a new paragraph (5). The draft proposal follows.

> "Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example:
>
> 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument;
> 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;
> 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock;
> 4) damages and other amounts received as the result of litigation;
> 5) property acquired by an agent on behalf of another;
> 6) tax refunds and other tax benefit recoveries;
> 7) pension reversions;
> 8) contributions to capital (except for sales of securities by securities dealers);
> 9) income from forgiveness of indebtedness; or
> 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.
>
> Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

For several reasons, the hearing officers recommend additional public review of and comment on the above Revised Draft II version of the proposal. A number of the hearing participants requested an opportunity to comment on any modified proposed definition and hearing officers believe that the importance of this kind of definition warrants thorough consideration by the public. Additionally, since the second hearing on the proposed definition was held in July 1999, courts in two states have released decisions that may have an impact on the proposed definition as currently drafted. California (*Hoechst-Celanese Corp. v. Franchise Tax Board*, No. C030702, December 3, 1999) and North Carolina (*Union Carbide Corp. v. Offerman*, No. 453A98-2, February 4, 2000) courts have each ruled that monies received from a pension reversion, which, according to the definition, are excluded from the definition of gross receipts but may nevertheless constitute business income, is not business income and therefore should be excluded from the taxpayer's tax base. In addition, North Carolina's highest court earlier ruled that litigation awards, which are specifically excluded from the definition of gross receipts, constitute business income and should be included in the taxpayer's apportionable tax base (*Polaroid v. Offerman*, 349 N.C. 290, 507 S.E.2d 284 (1998), cert. denied, --- U.S. ---, 143 L. Ed. 2d 671 (1999)).The recent decisions raise questions regarding the potential effect of the proposed definition on cases like these.

The hearing officers, therefore, wish to re-open the public comment period for this matter and request written public comment on the Revised Draft II of the proposed definition. We propose a 30-day public comment period after which the hearing officers will submit to the MTC Executive Committee a final report with recommendations.

Final Report of the Hearing Officers
regarding the
Proposed Definition of "Gross Receipts"

Hearing Notices

Exhibit B-1: Notice of Public Hearing, May 8, 1998

Exhibit B-2: March 1, 1999, notification of "informal dialogue" regarding proposed definition

Exhibit B-3: Notice of Public Hearing, July 8, 1999

Exhibit B-4: Notice and Request for Additional Public Comment, September 2000

Multistate Tax Commission

NOTICE OF PUBLIC HEARING

regarding a

PROPOSED DEFINITION OF "GROSS RECEIPTS"

The MULTISTATE TAX COMMISSION will conduct a public hearing regarding a proposed definition of the term "gross receipts" for the purpose of receiving comments from the public on whether the MTC should adopt the proposal as a uniformity recommendation to the States. This hearing session will be held at the following location on the date and at the time specified:

FRIDAY, MAY 8, 1998, 2:30 P.M. (EASTERN)
Hall of the States Building
444 North Capitol Street, N.W., Suite 235
Washington, D.C. 20001-1538

The MTC Uniformity Committee drafted a definition of "gross receipts" as a proposed amendment to the definitions section of the MTC regulations, Reg.IV.2.(a). The term "gross receipts" currently is not defined in UDITPA or in the MTC regulations. The term appears in UDITPA §1(g) in the definition of "sales" and becomes applicable in the MTC sales factor regulations under UDITPA §§15-17 and in various MTC regulatory provisions under UDITPA §18. The proposed definition reads as follows:

> "Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, ~~in~~ which income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for basis or cost of goods sold or property sold. Gross receipts do not include such items as repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument, the gross principal amount received under a repurchase agreement or other transaction properly characterized as a loan, proceeds from issuance of the taxpayer's own stock or from sale of treasury stock, damages and other amounts received as the result of litigation, property acquired by an agent on behalf of another, tax refunds and other tax benefit recoveries, pension reversions, contributions to capital, or income from forgiveness of indebtedness. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.

Public comment is sought on whether the MTC should adopt as a uniformity recommendation this proposed definition. General comments about the proposed definition as well as specific comments on the language of the proposal are encouraged. Please submit all questions, comments and correspondence regarding this hearing matter to:

René Y. Blocker, Hearing Officer
444 N. Capitol Street, N.W., Suite 425
Washington, D.C. 20001-1538
Phone: (202) 624-8699
Fax: (202) 624-8819
E-mail: rblocker@mtc.gov

All interested parties are invited to participate in this public hearing. Parties wishing to make formal oral presentations are requested to notify the Hearing Officer in writing at least two (2) working days prior to the hearing date. Written comments are acceptable and encouraged and may be provided any time prior to or on the hearing date or by such later date as may be announced for the closing of the public hearing period. Please note that interested parties may request the opportunity to participate in the hearing via telephone. Contact the Hearing Officer for information regarding participating telephonically.

Proposed Definition of Gross Receipts
for Purposes of Determining the Sales Factor
for Apportionment of Multijurisdictional Income

March 1, 1999

At its November, 1998 meeting, the MTC Executive Committee affirmed the plan of the hearing officers to engage in an "informal dialogue" with interested States and industry representatives to craft a definition of "gross receipts" that would be acceptable to both States and the taxpayer community. A second public hearing on the revised draft will be held May 4, 1999. Accordingly, attached for your review and comment is an amended draft of the proposed definition of gross receipts. The amendments reflect the public comments (written and oral) of interested parties and hearing participants received to date. For ease of comparison, we have forwarded a "red-lined" and a "clean" version of the definition.

Upon receipt of your comments and recommended changes (if any), to the amended draft, a third draft incorporating comments and recommended changes will be prepared and subjected to a second public hearing. Comments and other recommendations should be sent to Roxanne Bland, MTC Counsel, 444 North Capitol Street, N.W., Suite 425, Washington, D.C. 20001. Or, if you prefer, you may submit your contributions via fax (202/624-8819), or email (rbland@mtc.gov). To give MTC staff adequate time to review and incorporate submissions into the third draft, we would appreciate your comments by March 31, 1999.

To remind you, the MTC Uniformity Committee drafted a definition of "gross receipts" as a proposed amendment to the definitions section of MTC Reg. IV.2.(a). The term "gross receipts" is not currently defined in the Uniform Division for Income Tax Purposes Act (UDITPA) or in MTC regulations. The term appears in UDITPA at §1(g) under the definition of "sales" and becomes applicable in the MTC sales factor regulations under UDITPA §§15-17 and in various MTC regulatory provisions under UDITPA §18.

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Houston Audit Office:
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Houston, TX 77084-5131
Telephone 281.492.2260
Fax 281.492.0335

Multistate Tax Commission
Proposed Definition of Gross Receipts
February 8, 1999

D * R * A * F * T
(Double underlined text replaces strikethough text)

"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, fees, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for ~~basis or cost of goods sold or property sold~~ the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as ~~repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument, the gross principal amount received under a repurchase agreement or other transaction properly characterized as a loan, proceeds from issuance of the taxpayer's own stock or from sale of treasury stock, damages and other amounts received as the result of litigation, property acquired by a agent on behalf of another, tax refunds and other tax benefit recoveries, pension reversions, contributions to capital, or income from forgiveness of indebtedness.~~

- repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument,
- the ~~gross~~ principal amount received under a repurchase agreement or other transaction properly characterized as a loan,
- proceeds from issuance of the taxpayer's own stock or from sale of treasury stock,
- damages and other amounts received as the result of litigation, property acquired by a agent on behalf of another,
- tax refunds and other tax benefit recoveries,
- pension reversions,
- contributions to capital (except for sales of securities by securities dealers),
- income from forgiveness of indebtedness, or

- amounts realized as the result of short term investments or re-investments of principal in mutual fund accounts, money market accounts or similar instruments;
- amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code." (See IV.18(c) for proper treatment of receipts in the sales factor.)

~~Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.~~

Multistate Tax Commission
Proposed Definition of Gross Receipts
February 8, 1999

D * R * A * F * T

(Clean Version)

"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, fees royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as

- repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument,
- the principal amount received under a repurchase agreement or other transaction properly characterized as a loan,
- proceeds from issuance of the taxpayer's own stock or from sale of treasury stock,
- damages and other amounts received as the result of litigation, property acquired by a agent on behalf of another,
- tax refunds and other tax benefit recoveries,
- pension reversions,
- contributions to capital (except for sales of securities by securities dealers),
- income from forgiveness of indebtedness, or
- amounts realized as the result of short term investments or re-investments of principal in mutual fund accounts, money market accounts or similar instruments;
- amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code." (See IV.18(c) for proper treatment of receipts in the sales factor.)

Multistate Tax Commission

NOTICE OF PUBLIC HEARING

regarding a

PROPOSED DEFINITION OF "GROSS RECEIPTS"

The MULTISTATE TAX COMMISSION will conduct a public hearing regarding a proposed definition of the term "gross receipts" for the purpose of receiving comments from the public on whether the Commission should adopt the proposal as a uniformity recommendation to the States. This hearing session will be held at the following location on the date and at the time specified:

THURSDAY, JULY 8, 1999, 2:30 P.M. (EASTERN)
Hall of the States Building
444 North Capitol Street, N.W., Suite 231
Washington, D.C. 20001-1538

The MTC Uniformity Committee drafted a definition of "gross receipts" as a proposed amendment to the definitions section of the MTC regulations, Reg.IV.2.(a). See "Original Draft" included with this notice. The term "gross receipts" currently is not defined in UDITPA or in the MTC regulations. The term appears in UDITPA §1(g) in the definition of "sales" and becomes applicable in the MTC sales factor regulations under UDITPA §§15-17 and in various MTC regulatory provisions under UDITPA §18. The hearing officers have made suggested revisions to the Original Draft to account for comments received from interested state tax agency and business representatives. See "Revised Draft I" included with this notice.

Public comment is sought on both the Original Draft and the Revised Draft I. Specifically, interested parties are requested ~~to~~ to submit their comments on whether the specific language of either or both of the proposals sufficiently defines the term "gross receipts" and to identify potential difficulties that may arise in the application of the definition. General comments also are encouraged regarding whether the Commission should consider adoption of either of these proposals. Please submit all questions, comments and correspondence regarding this hearing matter to:

Roxanne Bland, Assistant Hearing Officer
444 N. Capitol Street, N.W., Suite 425
Washington, D.C. 20001-1538
Phone: (202) 624-8699; Fax: (202) 624-8819; E-mail: rbland@mtc.gov

All interested parties are invited to participate in this public hearing. Those wishing to make formal oral presentations are requested to notify the hearing officers in writing at least two (2) working days prior to the hearing date. Written comments are acceptable and encouraged and may be provided any time prior to or on the hearing date or by such later date as may be announced for the closing of the public hearing period. Interested parties may participate via telephone by dialing (703) 736-7307 at the time indicated for the hearing. Advise the operator that you wish to participate in the "gross receipts hearing" teleconference moderated by Roxanne Bland. The confirmation number for the call is 1632481.

Proposed Definition of "Gross Receipts"

ORIGINAL DRAFT	REVISED DRAFT I
"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for basis or cost of goods sold or property sold. Gross receipts do not include such items as repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument, the gross principal amount received under a repurchase agreement or other transaction properly characterized as a loan, proceeds from issuance of the taxpayer's own stock or from sale of treasury stock, damages and other amounts received as the result of litigation, property acquired by an agent on behalf of another, tax refunds and other tax benefit recoveries, pension reversions, contributions to capital, or income from forgiveness of indebtedness. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.	"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, fees royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include, for example, such items as: 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan; 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock; 4) damages and other amounts received as the result of litigation; 5) property acquired by an agent on behalf of another; 6) tax refunds and other tax benefit recoveries; 7) pension reversions; 8) contributions to capital (except for sales of securities by securities dealers); 9) income from forgiveness of indebtedness; or 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

Multistate Tax Commission

NOTICE AND REQUEST FOR ADDITIONAL PUBLIC COMMENT

regarding a

PROPOSED DEFINITION OF "GROSS RECEIPTS"

The MULTISTATE TAX COMMISSION announces its request for additional public comment regarding a Proposed Definition of Gross Receipts (*See Exhibit A attached.*). The MTC Uniformity Committee drafted a definition of "gross receipts" as a proposed amendment to the definitions section of the MTC regulations, Reg.IV.2.(a). The term "gross receipts" currently is not defined in UDITPA or in the MTC regulations. The term appears in UDITPA §1(g) in the definition of "sales" and becomes applicable in the MTC sales factor regulations under UDITPA §§15-17 and in various MTC regulatory provisions under UDITPA §18. Two public hearings have been held on this proposal. The Hearing Officers recently submitted a Second hearing report to the MTC Executive Committee, which included revisions to the proposed definition. (For a copy of the Second Hearing Officers' report, please visit the MTC's website at http://www.mtc.gov/MEETINGS/pubhrgs.htm or call (202) 624-8699.)

Additional public comment is sought with respect to the current revised draft definition (*Revised Draft II*). Moreover, the Hearing Officers seek the public's views on the potential impact on this proposed definition of recent decisions by state supreme courts concerning the character of income received through litigation awards and pension reversions. The current proposed definition of gross receipts (*Revised Draft II*) reads as follows:

> "Gross receipts"—are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example:
>
> 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument;
> 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;
> 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock;
> 4) damages and other amounts received as the result of litigation;
> 5) property acquired by an agent on behalf of another;

6) tax refunds and other tax benefit recoveries;
7) pension reversions;
8) contributions to capital (except for sales of securities by securities dealers);
9) income from forgiveness of indebtedness; or
10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.

Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

The Hearing Officers have determined that it is appropriate to extend the comment period in order to receive public comments on the potential effect of these decisions on the proposed definition of gross receipts. Accordingly, the written comment period has been extended to **October 13, 2000**. Additionally, the Hearing Officers seek public comment in general on the current revised draft. Once the responses have been reviewed, the Hearing Officers will issue an additional report to the MTC Executive Committee with recommendations regarding adoption of the proposal.

Please direct correspondence and any questions regarding this notice or the Report to:

Roxanne Bland, Hearing Officer
444 N. Capitol Street, N.W., Suite 425
Washington, D.C. 20001-1538
Phone: (202) 624-8699
Fax: (202) 624-8819
E-mail: rbland@mtc.gov

All interested parties are invited to submit written comments. Electronic communications are acceptable and specifically encouraged. Comments received by October 13, 2000, will become part of the public record.

EXHIBIT.

Proposed Definition of "Gross Receipts"
Side-by-Side Comparison of Revised Versions (July 2000)

ORIGINAL DRAFT	REVISED DRAFT I	Revised Draft II
"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for basis or cost of goods sold or property sold. Gross receipts do not include such items as repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument, the gross principal amount received under a repurchase agreement or other transaction properly characterized as a loan, proceeds from issuance of the taxpayer's own stock or from sale of treasury stock, damages and other amounts received as the result of litigation, property acquired by an agent on behalf of another, tax refunds and other tax benefit recoveries, pension reversions, contributions to capital, or income from forgiveness of indebtedness. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.	"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, fees royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include, for example, such items as: 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate, of deposit or similar marketable instrument; 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan; 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock; 4) damages and other amounts received as the result of litigation; 5) property acquired by an agent on behalf of another; 6) tax refunds and other tax benefit recoveries; 7) pension reversions; 8) contributions to capital (except for sales of securities by securities dealers); 9) income from forgiveness of indebtedness; or 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.	"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example: 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan; 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock; 4) damages and other amounts received as the result of litigation; 5) property acquired by an agent on behalf of another; 6) tax refunds and other tax benefit recoveries; 7) pension reversions; 8) contributions to capital (except for sales of securities by securities dealers); 9) income from forgiveness of indebtedness; or 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness ' income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

Final Report of the Hearing Officers
regarding the
Proposed Definition of "Gross Receipts"

Written Public Comments

Exhibit C-1: Letter, AZ Dept. of Rev., May 7, 1998

Exhibit C-2: E-mail, CO Dept. of Rev., May 7, 1998

Exhibit C-3: E-mail, Robert Feinschreiber and Margaret Kent, May 8, 1998

Exhibit C-4: Letter, Kansas Dept. of Rev. May 26, 1998

Exhibit C-5: E-mail, The Williams Companies, Inc., June 25, 1998

Exhibit C-6: Letter, NM Tax. and Rev. Dept., June 26, 1998

Exhibit C-7: Letter, AK Dept. of Rev., July 1, 1998

Exhibit C-8: E-mail, North Dakota, June 25, 1999

Exhibit C-9: Letter, Baker & McKenzie, June 30, 1999

Exhibit C-10: Letter, AICPA, October 11, 1999

Exhibit C-11: E-mail, MI Dept. of Treas., August 8, 2000

Exhibit C-12: E-mail, OR Dept. of Rev., October 10, 2000

ARIZONA DEPARTMENT OF REVENUE

1600 WEST MONROE - PHOENIX, ARIZONA 85007-2650

JANE DEE HULL
GOVERNOR

MARK W. KILLIAN
DIRECTOR

May 7, 1998

Rene Y. Blocker
Multistate Tax Commission
444 N. Capitol Street, N.W.
Suite 425
Washington, D.C. 20001-1538

Dear Ms. Blocker:

The following comments are made with regard to the proposed definition of "gross receipts".

The term "similar instruments" could be misleading in the context in which it was used. Taxpayers may believe that the term connotes only a debt instrument of some type. We would like to see the term expanded upon, either by including additional definitions (e.g., mutual funds, money market accounts) or the term could be included in a separate sentence such as "'Gross receipts' do not include amounts realized as the result of short term investments or re-investments of principal in mutual fund accounts, money market accounts, or similar instruments."

It is our interpretation that the addition of this definition would not preclude the application of Reg.IV.15.(a)(1)(F)(2) or Reg.IV.18.(c) to modify the gross receipts included in the sales factor. However, because the definition is fairly detailed and is adopted subsequent to a certain amount of controversy over the sales factor, some taxpayers may try to view this as a definitive statement of what is included in the sales factor.

We appreciate the opportunity to comment on the proposed definition. If you have any questions, you may call me at (602) 542-4672, extension 8809 or Tamara Harris at (602) 542-3345, extension 4540.

Sincerely,

George Courtney
Tax Analyst
Tax Research & Analysis Section

f:98let\mtcrec

OTHER LOCATIONS: Tucson Government Mall - 400 W. CONGRESS - TUCSON
East Valley - 1440/1460 E. SOUTHERN - TEMPE

EXHIBIT C-1

Bowman, Ana (Tina)

From: Bowman, Ana (Tina)
Sent: Thursday, May 07, 1998 10:57 AM
To: 'Rene Y. Blocker'
Subject: Gross Receipts Definition

René,

We want to request an addition to the proposed definition. On line 9, where it says, ...Gross receipts do not include such items as repayment..., we'd like to add "short-term investments by non-financial institutions" (week-enders or over-nighters). In Colorado's opinion, the inclusion of such investments in gross receipts would incorrectly inflate the denominator of the revenue factor.

We'd like to know if other states have raised this issue. Please let me know if you need more details or if you want us to write a memo about it.

Tina Bowman
Colorado Department of Revenue
FAX: (303) 355-0951
E-mail: abowman@spike.dor.state.co.us

From: Multijur <Multijur@aol.com>
Date: Fri, 8 May 1998 08:20:04 EDT
To: rblocker@mtc.gov
Subject: proposed definition of "gross receipts"

The proposed definition is interesting, but more fine tuning would be helpful.
Consider the following:
1. Are "gross revenues" and "gross receipts" equivalent? In not, how do they differ?
2. Are gross amounts "realized" to equate to the recognition of gain or loss? How do we adjust when these two amounts differ?
3. The reference to "business income" in the context of the gross receipts definition appears to be confusing. Shouldn't "gross receipts" definition apply, whether or not the receipts are for business or for non-business purposes?
Robert Feinschreiber and Margaret Kent Multijur@aol.com

EXHIBIT C-3

STATE OF KANSAS
Bill Graves, Governor

DEPARTMENT OF REVENUE
John D. LaFaver, Secretary

Shirley K. Sicilian, Director
Office of Policy & Research
Kansas Department of Revenue
915 SW Harrison St.
Topeka, KS 66612-1588

(785) 296-3081
FAX (785) 296-7928
Hearing Impaired TTY (785) 296-3909
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Office of Policy & Research

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MTC/DC

May 26, 1998

Rene Y. Blocker, Hearing Officer
Multistate Tax Commission
444 N. Capitol Street, N.W. , Suite 425
Washington, D.C

RE: Definition of Gross Receipts

Dear Ms. Blocker:

I circulated the MTC proposal for a definition of "gross receipts" to interested staff members. I received two comments from staff. The first comment was the observation that a uniform regulation is needed and that the MTC proposal is consistent with the following statement made in this years Kansas Corporate Income Tax Booklet:

> LINE C-SALES FACTOR— ... (f) In the case of a taxpayer engaged in the sale or redemption of investment securities, "sales" includes the interest or other income from such transactions. The term "sales" does not include the return of capital or the recovery of principal utilized to make such investments.

I believe that this statement published by Kansas for taxpayer guidance reflects the MTC definition of "gross receipts."

The second auditor comment is:

> 'In my opinion, the proposed definition gets more wordy and less clear with each new version. This one, with all its parenthetical phrases, is awful. Two specific comments:
> 1. "Gross receipts do not include such items as repayment......" This list is long and fairly specific. Will it cover short term investment in money market accounts and/or other types of securities that have not been invented yet?
> 2. By the time you read the entire paragraph, is it clear that gross receipts **do** include the gain, loss or interest income from the types of transactions not included in gross receipts?
>
> Audit policy is to use gross receipts from the sale of tangible property and net receipts from the sale of intangibles. Our canned explanation provided by DPIII is:
>
> The sales factor has been adjusted to exclude from it the gross proceeds from the sale of interest-bearing securities. Income from them has been included in the sales factor. The reasons for this adjustment are explained in *American Tel. and*

EXHIBIT C-4

> *Tel. v. Taxation Div. Director*, 194 N.J. Super. 168 (1984), *American Tel .and Tel. v. Tax Appeal Bd.*, 787 P.2d 754, Syl. 1, (Mont. 1990) and *Appeals of Pacific Telephone and Telegraph Company,* Cal. Tax Rpts. (CCH) 205-857 (May 4, 1978).

> We see this issue often on audits. We would be very happy to get a uniform regulation. Hopefully, Kansas would adopt it immediately.'

I hope that these comments are useful to you. Please call me at (785) 296-4010 if you need to discuss this matter further.

Sincerely,

Tom Hatten

Thomas E. Hatten
Attorney/Policy & Research

From: David Wulf [DWulf@fin.twc.com]
Sent: Thursday, June 25, 1998 9:17 AM
To: rblocker@mtc.gov
Cc: dsmith@statetax.org; jfriedman@statetax.org
Subject: Gross Receipts

Comments on the Proposed Definition of Gross Receipts -
I had a little trouble following some of this. In the first sentence, I'd suggest: ...the performance of services, or from the use of property or capital (e.g. rents, royalties, interest, and dividends) in a transaction...
In the second sentence, I'd suggest: ...are not reduced for the cost of goods sold or the basis of the property sold. The third sentence is way to long. I'd suggest going to a numbered list of the items mentioned.
The fourth sentence has nothing to do with the definition of gross receipts and should be deleted. I realize nonbusiness income is a sensitive subject, but the definition of gross receipts is not the place to make this point. Rather, the definition of non-business income is the place where this sentence should appear. I would strongly urge you not to mix bits and pieces in different places, because that is what we do in Oklahoma. The result is a most shamefully convoluted statute. If you'd like to see the result of such and approach, read the Oklahoma income tax statute (68 OS 2358).
I appreciate the opportunity to comment on this proposed regulation.
Regards,
David Wulf
The Williams Companies, Inc.
Tulsa, OK

EXHIBIT C-5

Gary E. Johnson
Governor

John J. Chavez
Secretary

STATE OF NEW MEXICO

Taxation and Revenue Department

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Motor Vehicle
(505) 827-2294
Property Tax
(505) 827-0870
Revenue Processing
(505) 827-0800

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June 26, 1998

René Y. Blocker, Hearing Officer
Multistate Tax Commission
444 North Capitol Street NW, Suite 425
Washington DC 20001-1538

Dear Ms. Blocker:

I apologize for our untimely response regarding the proposed definition of "gross receipts". Nonetheless here are some comments.

As a stylistic point, perhaps it would be better to start the third sentence with: "The term 'gross receipts" excludes ...."

We're not sure the last sentence works since the first sentence ties the definition of "gross receipts" to whether or not a transaction produces business income. If by regulation something is not "gross receipts", states will have an uphill battle trying to argue in court that, nonetheless, the something is business income.

Although we've thought about it some, we're still not sure what problem this is addressing. That makes it more difficult to evaluate the proposal. As a result, we'll probably not adopt it until after some other states have had litigation experience with it.

Sincerely,

James P. O'Neill
Director of Tax Policy

EXHIBIT C-6

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPARTMENT OF REVENUE
INCOME AND EXCISE AUDIT DIVISION

550 WEST 7TH AVENUE, SUITE 560
ANCHORAGE, ALASKA 99501
(907) 269-6620 FAX (907) 269-6644

JUL 0 8 1998

July 1, 1998

René Y. Blocker, Hearing Officer
Multistate Tax Commission
444 N. Capitol Street N.W., Suite 425
Washington D.C. 2001 - 1538

Re: Proposed Definition of Gross Receipts

Dear René,

This letter follows the discussion during the formal hearing of 5/8/98. Alaska is concerned that the draft definition of gross receipts could be interpreted to support including in the sales factor the "gross receipts" derived from the exchange of crude oil inventory by oil and gas taxpayers. The MTC draft states: "gross receipts are the gross amounts realized...on the sale or ***exchange of property*** in a transaction which produces business income, ***in which income or loss is recognized...under the Internal Revenue Code***".

Crude oil exchanges are routine among oil companies in order to minimize transportation costs. Exchanges allow oil companies to trade for suitable crudes that are produced nearest to their refineries. An oil exchange usually includes a cash differential that represents the differences in the quality of the crudes exchanged and transportation costs. There are a variety of generally accepted accounting methods used to account for exchanges, the common characteristic being that *gain or loss for each exchange is not recognized.* Exchanges and the related cash differentials are usually accounted for as inventory adjustments - no gross receipt is recorded. Gains and losses from the exchange transactions are deferred until outside sales occur.

Both GAAP and the Internal Revenue Code support the gain deferral accounting treatment. Under APB 29, an exchange of inventory is not the culmination of the earnings process and gains are recognized only upon, and limited to, the receipt of boot. For tax accounting, IRC sec. 446 says that the taxpayers book accounting is acceptable for tax purposes if it clearly reflects income. IRC sec. 471 requires inventory methods to conform to the best industry accounting practices. For these reasons Alaska does not include "gross receipts" derived from the exchanges of crude oil in the sales factor.

While the majority of oil companies use a gain deferral method for federal tax purposes, support for an alternative federal tax treatment is found at IRC sec. 1001.

This section gives the general rule that a taxpayer must recognize gain or loss on exchanges of property. For tax accounting purposes, IRC sec. 1001 could be applied to *each* exchange transaction. This would result in a gross receipt recognized for each exchange, with corresponding, and offsetting gains and losses. The federal tax effect of this method would be the same as an inventory adjustment method. However, it would significantly increase and inappropriately overstate the sales denominator. We believe the regulation might be clarified to convey the rule that exchanges of inventory of this nature do not generate gross receipts for sales factor purposes.

You indicated that other oil producing states might be surveyed for comment on this issue. We are very interested in comment about our technical analysis of this issue and whether other states think this question has enough broad application to warrant revision to the current language. In the alternative, we will be considering whether an industry specific Alaska regulation or modification would be appropriate. If I can assist in any way please let me know.

Sincerely,

Mark Graber
Audit Manager
(907) 269-6626

cc: Deborah Vogt
Larry Meyers

Bland, Roxanne

From: Aldinger, Harold J. [haldinge@state.nd.us]
Sent: Friday, June 25, 1999 5:09 PM
To: 'rbland@mtc.gov'
Subject: Proposed Definition of "Gross Receipts"

We will not be participating in the public hearing on July 8, 1999, but would like to offer the following comments:

1. We would like to see the last sentence of the original draft (Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.) added to the Revised Draft I.
2. If royalties, interest, and dividends are to be included in the "gross receipts" denominator, how will these items be assigned to the numerator?

   Thanks for the opportunity for input. Please contact me if you have any questions.

Harold Aldinger

North Dakota

EXHIBIT C-8

BAKER & McKENZIE

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June 30, 1999

Roxanne Bland
Assistant Hearing Officer
Multistate Tax Commission
444 North Capitol Street, N.W.
Suite 425
Washington, D.C. 20001 - 1538

Re: Proposed Definition of Gross Receipts for Purposes of Determining the Sales Factor for Apportionment of Multijurisdictional Income

Dear Ms. Bland:

We are writing to comment on the draft regulations dealing with the proposed definition of gross receipts. The MTC's notice of public hearing indicated that comment is sought on both the "Original Draft" and the "Revised Draft I," but we note that there was also an interim draft dated February 8, 1999. In this letter, we include comments to the February 8, 1999 version as well as comments to the Revised Draft I version.

We have previously had some exposure to the issue of gross receipts for sales factor apportionment purposes and consider this area to be both interesting and important. We appreciate the opportunity to comment on the proposed regulations. We begin our comments with the February 8, 1999 draft.

Comments to February 8, 1999 Draft Regulations

We are particularly concerned with the last sentence in the February 8, 1999 version containing the list of excluded items. (The Original Draft includes some of these items and in some cases uses the same language as used in the February 8, 1999 version; however, as noted below, the February 8, 1999 version introduced some additional problems that were not present in the Original Draft; fortunately, these problems appear also to have been eliminated in Revised

Draft I.) Although very specific in some respects, this list of the items that are not included in the definition of gross receipts also creates significant ambiguity and confusion. Is the list of excluded items exhaustive such that only items listed are excluded? Or is the list more open-ended and at times just suggestive of items to be excluded? The list appears not intended to be exhaustive because there are two instances when the list includes "similar instruments" to the specific listed items.

The first time the words "similar instrument" appears is in the item:

> "repayment, maturity, redemption of the principal of a loan, bond, certificate of deposit or similar instrument." (This phrase was included in the Original Draft in these exact words.)

In this instance, the meaning of similar instrument probably can be deduced from the context. It seems to mean, roughly, similar instruments evidencing debt or obligation to pay money. The point of this item would seem to be that repayment by the obligor or maker of the instrument does not cause the recipient to include the amount in gross income. If such intention underlies this item, it would be helpful to illustrate the item with an example in which it could be explained that the reason gross receipts do not arise is that the transaction directly involves return of money by the borrower back to the lender.

Far more problematic is the second instance where the words "similar instruments" are used:

> "amounts realized as the result of short term investments or reinvestments of principal in mutual fund accounts, money market accounts or similar instruments." (We note that this item was not included in the Original Draft and was added in the February 8, 1999 draft.)

To begin with, it is not entirely clear that the phrase "similar instruments" is part of the list "mutual fund accounts, money market accounts or similar instruments" rather than being parallel with "investments or reinvestments . . . or similar instruments." The former appears to be the intended construction, but the phrase is still inherently inconsistent and confusing because mutual fund accounts and money market accounts are not instruments.

While we realize that the tax regulations do not have to use words in the same fashion they are defined in other uniform laws (e.g., the Uniform Commercial Code), it nevertheless is useful to look to other uniform laws to get a sense of commonly accepted meanings. An account under the Uniform Commercial Code Sec. 4-104(a)(1), as applicable to bank deposits, means "any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit." Under Article 9, Section 106, the Uniform Commercial Code defines account as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper." The official comment indicates that an account is generally understood as the ordinary commercial account receivable. An instrument, on the other hand, as defined by UCC Sec. 9-105(i) means "a negotiable instrument, or other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in the ordinary course of business transferred by delivery with any necessary endorsement or assignment. The term does not include investment property." The term instrument suggests items such as a note or a check but does not include investments in mutual fund companies.

The phrase is confusing because it is like saying "oil, water, alcohol, or similar precious metals." Just as metals are not a liquid like oil, water or alcohol, instruments are not accounts like mutual fund accounts or money market accounts. In any event, we think that the phrasing of this item needed clarification, and, as explained below, the revised treatment of this item in Revised Draft I is a significant improvement.

Examples should clarify which items are excluded from gross receipts and why. For example, is the rationale underlying this exclusion, as in the first instance when the words similar instrument were used, that repayments of principal by the obligor should not be included in gross receipts? Perhaps the reasoning is that investments in money market funds are sufficiently similar to placing money in an interest-bearing bank account or making a loan to another person that all these methods of "lending" money ought to be treated similarly. If this is the rationale for the exclusion, it should be clearly stated so as to reduce confusion as to the aim and the application of this exclusion. The exclusion from gross receipts of mutual fund accounts is a little harder to justify under this rationale because it is less like a lending transaction where the lender's principal is returned to him by the borrower. Nevertheless, in one superficial sense investment in a mutual fund may, in some cases, be similar to a loan or investment in a money market fund; that is, in these cases, the person or entity to which the taxpayer transfers its funds (i.e., fund manager or custodian) is also the person or entity that returns funds to the taxpayer. However it seems to be stretching the point to include investments in mutual funds in this category. Moreover, instead of specifying that investments in "similar instruments" will be excluded from gross receipts, we suggest that the regulations specify that investments in mutual funds, money market funds and similarly pooled investment funds do not generate gross receipts to the extent of the principal balance returned to the investor or lender.

As written in the February 8, 1999 draft, the exclusion of "mutual fund accounts, money market accounts or similar instruments" might have invited the interpretation that any investment in the kinds of things that mutual funds invest in are excluded from the definition of gross receipts because the phrase <u>similar instruments</u> lends itself to such an interpretation. If the MTC is still considering the concepts behind the February 8, 1999 draft, the regulations should clarify whether the investment in the mutual fund itself is what causes the receipts to be excluded from the definition of gross receipts or whether investments in the same properties in which mutual funds invest would also be excluded from the definition of gross receipts. The latter interpretation might mean that dividends and capital gains income would always be excluded from the definition of gross receipts. The former interpretation would suggest that clarification is needed to specify what other investments besides mutual funds and money market funds should be excluded. If only investments in mutual funds or money market funds are excluded, then the words "similar instruments" should be deleted. Again, as noted above, investments in mutual funds and money market funds should produce accounts and not instruments, as the terms "account" and "instrument" are commonly understood and as defined in the UCC.

One other alternative reading of the section relating to mutual funds is that the exclusion is directed at "*short term* investments or reinvestments" in mutual fund accounts and money market accounts. This would suggest that long term investments and reinvestments are not excluded. If this is the aim of the regulations, then the Commission needs to provide guidance as to what distinguishes short term investments from long term investments. And again, there is ambiguity as to what other investments are excluded besides short term investments in mutual funds and money market funds. Some, but probably not all, of the ambiguity arises from the phrase "similar instruments." As noted above, examples would help to clarify the meaning of this provision.

Comments Regarding the Revised Draft 1

In comparing the Original Draft, the February 8, 1999 draft and the Revised Draft I, we think that the Revised Draft I is substantially clearer than the prior two drafts. In particular, it is a notable improvement over the February 8, 1999 version. The exclusion from gross receipts of "repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument" leaves few doubts that the exclusion is intended to apply to the principal of the loan, bond, mutual fund, certificate of deposit or similar marketable instrument. Here, the intent appears clear that repayments of principal by the obligor should not be included in gross receipts but, as we noted above, this rationale does not necessarily support the exclusion of investments in mutual funds. Unlike the other instruments included in the list, investments in mutual funds are not instruments as explained above. Moreover, by excluding the return of principal from mutual fund investments from the definition of gross receipts, does the exclusion also apply if the taxpayer were to invest in stocks directly? A share of stock is arguably a marketable instrument such that the return of principal is excluded under the terms of this definition. Presumably there could be some logic to excluding from gross receipts an amount received when the issuer redeems a share of stock in that in some sense this is like repayment of a loan. The holder of the loan or share of stock is receiving something from the issuer in repayment or redemption. If this is the intent of this definition, then would it be fair to say that there is no meaningful distinction between loans and investments such that both will be treated the same with respect to determining what amount is included or excluded from gross receipts? Again, we suggest that the Commission articulate the rationale behind these exclusions to reduce the likelihood of misreading its intent. Furthermore, we think the Commission should provide some examples of what other instruments which are not classified as a loan, bond, certificate of deposit, or a (share in a) mutual fund that would result in repayment of principal such that the principal amount is not included in gross receipts.

Another issue is why the word "marketable" is used to modify "instrument." This is a minor point but in order to prevent future litigation over whether the principal from all instruments is excluded or only that from marketable instruments is included, the Commission should consider clarifying the use of "marketable" in this context. Not to bore you with the same point, but we think that examples might be used to clarify the use of marketable to modify instrument.

Additionally, perhaps the Commission should consider providing some guidance as to why the amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold (which we believe is the correct position) but that this is not the case for investments in mutual funds. Gross receipts is defined as the "gross amounts realized ... on the sale or exchange of property, the performance of services, or the use of property or capital ... in a transaction which produces business income." There is no obvious reason why amounts realized from the sale of property should be treated differently than amounts realized from the use of property (i.e., the use of funds to generate income).

The foregoing comments are made primarily in order to seek clarification of what is being excluded from gross receipts. Once we are better able to understand what is being excluded and the conceptual basis for those exclusions, we may have substantive comments on the inclusion or exclusion of specific items. We hope that the Commission will revise the definition so as to clarify the ambiguities we have found and discussed above.

Very truly yours,

J Pat Powers

J. Pat Powers

JPP

RECEIVED
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MTC/DC

October 11, 1999

Ms. Roxanne Bland
Assistant Hearing Officer
Multistate Tax Commission
444 N. Capitol Street, N.W.
Suite 425
Washington, D.C. 20001-1538

Dear Ms. Bland:

Enclosed are the American Institute of Certified Public Accountants comments on the Multistate Tax Commission (MTC) Proposed Definition of "Gross Receipts". These comments were developed by members of the State and Local Taxation Committee.

We would be pleased to discuss the comments and proposed definition with you or a member of your staff. You may contact one of the following: me at (212) 572-5555; Karen J. Boucher, Chair of the State and Local Taxation Committee, at (414) 283-3621; or Eileen Sherr, AICPA Technical Manager, at (202) 434-9256

Sincerely,

David A. Lifson

David A. Lifson
Chair
Tax Executive Committee

Enclosure

EXHIBIT C-10

AICPA
ISO9001

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments Regarding Multistate Tax Commission Proposed Definition of Gross Receipts

Prepared By:

State & Local Taxation Committee
Karen J. Boucher, Committee Chair
Eileen Sherr, Technical Manager

Approved By:

STATE AND LOCAL TAXATION COMMITTEE

And the

TAX EXECUTIVE COMMITTEE

Submitted to the Multistate Tax Commission

October 11, 1999

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
Comments Regarding Multistate Tax Commission
Proposed Definition of Gross Receipts
October 11, 1999

GENERAL COMMENTS

The Multistate Tax Commission (MTC) Uniformity Committee has drafted a definition of "gross receipts" as a proposed amendment to the definitions section of the MTC regulations, Reg.IV.2.(a). Presently, neither the Uniform Division for Income Tax Purposes Act (UDIPTA) nor the MTC regulations provide a definition for "gross receipts".

The Notice of Public Hearing indicates that the MTC is seeking public comment on both the Original Draft and the Revised Draft I which were attached to the notice. We do not support either definition for two reasons. First, if the plain language of a statute requires the inclusion of total sales in the sales factor and defines sales as gross receipts, then absent statutory changes to UDITPA and the adopting states' statutes, the MTC's adoption of a regulation limiting the definition of sales to net receipts does not appear to be authorized. Secondly, if the purpose of the definition is to eliminate situations state tax administrators believe are abusive, we would like to point out that in those unique circumstances where inclusion of receipts results in distortion, the appropriate remedy to limit sales to net receipts is already sanctioned under section 18 of UDITPA.

In the event the MTC decides to continue with this regulation project, we believe that the Revised Draft I requires less clarification than the Original Draft and as such our comments will be limited to the Revised Draft I. Aside from our overall apprehension addressed in the previous paragraph, our primary concern with the draft is the removal of the ambiguity in the proposed definition. In the spirit of cooperation, we suggest the following specific issues be addressed and clarified as discussed below.

SPECIFIC COMMENTS

The revised draft defines "gross receipts" as:

> *[T]he gross amount realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, fees, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of the property are not reduced for the cost of goods sold or the basis of the property sold.*

Our specific concerns with this portion of the proposed definition include:

- The definition of gross receipts as the gross amounts realized from the listed transactions seems to be appropriately broad. Nevertheless, it is not clear what an "exchange of property" is intended to represent. Perhaps the definition should be modified to conform to the commonly cited definition of "sale" for sales tax purposes – that is, "the transfer of title or possession of property," which would encompass sales, leases, and exchanges.

- Although the proposed definition refers to income recognized under the Internal Revenue Code (IRC), it is not clear how the definition may be affected by intercompany transaction rules under Treas. Reg. §1.1502-13 ("-13 regulations"). The definition should be modified to clarify how these regulations should be taken into account in determining gross receipts.

  Most combined reporting states do not require multistate enterprises to include intercompany transactions in the sales factor for state apportionment purposes. Income or loss produced from transactions between related entities is usually eliminated from the sales factor because these transactions are seen as occurring within one indivisible entity, i.e. the unitary enterprise. However, this treatment may not be consistent with the treatment of intercompany transactions under the federal consolidated return regulations.

  Under the federal consolidated return regulations,[1] the amount of income or loss relating to intercompany transactions between affiliated corporations is first determined on a separate entity basis.[2] Then the related affiliates are treated as separate divisions of a single entity in determining the timing. The regulations contain a number of rules for subsequently determining when these "intercompany items" are "taken into account" on the federal consolidated return. By defining gross receipt as the "gross amounts realized...in which the income or loss is recognized under the Internal Revenue Code", intercompany items that were eliminated from the sales factor for state apportionment purposes now may be included currently in the sales factor. The federal intercompany transactions regulations include specific rules for a number of the intercompany transactions mentioned in the MTC draft, including:

  (1) intercompany sales of intangible property;
  (2) intercompany gains and losses from the disposition of tangible personal property;
  (3) intercompany performance of services; and
  (4) intercompany dividends received.

[1] See 26 U.S.C. § 1502 and corresponding regulations dealing with intercompany transactions, U.S. Treas. Reg. §§ 1.1502-13 *et. seq.*

[2] U. S. Treas. Reg. §1.1502-13(a)(2).

If a state requires separate returns, the application of the "-13 regulations" is even less clear. Presumably, a state might want to include items as "gross receipts" of a separate taxpayer even if they are eliminated or deferred for federal tax purposes. However, that intent is not apparent based on a plain reading of the proposed definition.

The federal intercompany regulations do not cover intercompany transactions between foreign and domestic affiliates, since foreign affiliates will not be included in the federal consolidated return. Accordingly, transactions between domestic and foreign affiliates are treated as transactions between unrelated corporations at the federal level. The Commerce Clause precludes states from discriminating against foreign commerce. Therefore, strict compliance with the federal rules cannot be tolerated when transactions with foreign affiliates are included but identical transactions with domestic affiliates are not. *Kraft General Foods, Inc. v. Iowa Dep't of Revenue*, 505 U.S. 71 (1992). Nevertheless, the appropriate treatment of transactions between a related U.S. and foreign entities is not clear. The language "or would be recognized if the transaction were in the United States" should be modified to ensure that the regulations do not violate the Commerce Clause.

- The treatment of income that is exempt under the IRC but taxable by the states (e.g., municipal bond interest) would appear to be excluded by the above definition, while income taxable under the IRC but classified as non-taxable by the states (e.g., interest on U.S. obligations) would appear to included in the factor because it is recognized for federal tax purposes even though it may not be subject to state income tax. The definition should be clarified to provide that only income that is included in the state tax base is includible in the sales factor.

- In circumstances where income or loss is recognized for Federal purposes yet no money or property is received (i.e. foreign exchange gain/losses) it is unclear whether the intent is to exclude such income from gross receipts.

The proposed definition continues with examples of what does <u>not</u> constitute "gross receipts"

Gross receipts, even if business income, do not include, for example, such items as:

1) *repayment, maturity, or redemption of the principal of a loan, bond, mutual fund or certificate of deposit or similar marketable instrument;*
2) *the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;*
3) *proceeds from the issuance of the taxpayer's own stock or from sale of treasury stock;*

4) damages and other amounts received as the result of litigation;
5) property acquired by an agent on behalf of another;
6) tax refunds and other tax benefit recoveries;
7) pension reversions;
8) contributions to capital (except for sales of securities by securities dealers);
9) income from forgiveness of indebtedness; or
10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.

Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

Our specific concerns with the exclusionary examples portion of the proposed definition include:

- The above list of items that are excluded from the definition of gross receipts creates ambiguity and confusion in that it is unclear whether the list is exhaustive, such that only items listed are excluded, or merely suggestive.

- Equally important is the fact that it is not clear why these specific items do not constitute gross receipts. For example, why are litigation damages excluded from gross receipts? If the damages constitute business income and are a recovery of income in lieu of profits, why are they not included in gross receipts? To provide more guidance to taxpayers and to ensure that the MTC is not arbitrarily trying to exclude certain items from the gross receipts, the rationale for excluding the 10 categories of items from the definition should be clearly provided. Upon receipt of the reasons why the specific items are excluded from the gross receipts definition, we may have additional comments regarding the inclusion or exclusion of items from the definition.

- In addition, examples of the specified excluded items should be added to reduce confusion as to the aim and application of the exclusions. For example, the first excluded item "repayment, maturity or redemption of the principal of a loan, bond or mutual fund or certificate of deposit or similar marketable instrument" is troubling. It is unclear what items may be considered to be "similar marketable instruments", or for that matter how "marketable" and "instruments" as used in that phrase are defined.

- The definition does not provide adequate distinctions between when to include the full sales price of an asset or just the income from the asset. For example, how are the sales or redemptions of zero coupon bonds or US Savings Bonds treated? Are these considered loans or assets?

- It is unclear what value or clarification the final item provides. The first part of the definition states "gross receipts" are the amounts recognized under the IRC. This infers that all income not recognized under the IRC is to be excluded. Providing a specific listing of income not recognized under the IRC as excluded from gross receipts is a redundancy that will only create more confusion.

- The provision provided in item #8 may be better suited for item #1.

CONCLUSION

Clearly, further clarification should be provided through specific definitions of terminology used and explanations of the reasoning behind the examples given. At this time we do not support the adoption of the current proposed definition; however, if the MTC decides to continue with this regulation project, we encourage the MTC to modify the definitions for the comments received and prepare another draft. We welcome the opportunity to discuss these comments with the MTC staff informally, or in the context of a working group.

-----Original Message-----
From: Thomas Halick [mailto:HalickT@state.mi.us]
Sent: Tuesday, August 08, 2000 8:56 AM
To: rbland@mtc.gov
Subject: Gross Receipts Proposed Regulation

Roxanne,

I have a few questions regarding the proposed MTC regulation to define gross receipts. Michigan is working on a statutory definition of "sales" and "gross receipts" for Single Business Tax purposes.

1. What is the purpose of adopting a definition of gross receipts? Are there specific persons calling for this definition?

2. Your proposed definition excludes from gross receipts "property acquired by an agent on behalf of another." Why do you apply this exception to property but not "amounts" or "proceeds?" Are there situations where an agent merely handles money for a principal and the amount is not accounted to the agent as a receipt? For example: a property management company receives an amount that it pays on behalf of the property owner for taxes, insurance, utilities, mortgage payments. Or, a service firm (agent) hires a third party to perform certain services for the principal?

3. "Sales" means all "gross receipts" not allocated. What would be included in gross receipts, but not included in "sales?" Are gross receipts and sales the same except for receipts that constitute allocable nonbusiness income?

notice that Texas regulations define gross receipts as "all revenues that would be recognized annually under a generally accepted accounting principles method of accounting, without deduction..." Have you considered such an approach?

Thanks,

Tom Halick
Tax Counsel
Michigan Dept. of Treasury
Bureau of Revenue
Legal & Hearings

EXHIBIT C-11

-----Original Message-----
From: HAMILTON Leonard M [mailto:Leonard.M.Hamilton@state.or.us]
Sent: Tuesday, October 10, 2000 6:26 PM
To: 'rbland@mtc.gov'
Cc: SCOTT John C; MCCLAIN Stanley J
Subject: Comments re. MTC Proposed Definition of Gross Receipts

The Oregon Department of Revenue recommends adoption of the MTC's proposed definition of "gross receipts". No changes are recommended to the proposal.

We believe that Oregon laws will require some legislative changes to fully conform to the MTC proposal.

EXHIBIT C-12

Final Report of the Hearing Officers
regarding the
Proposed Definition of "Gross Receipts"

Exhibit D: Side-by-Side Comparison of Revised Versions (July 2000)

Proposed Definition of "Gross Receipts"
Side-by-Side Comparison of Revised Versions (July 2000)

ORIGINAL DRAFT	REVISED DRAFT I	REVISED DRAFT II
"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for basis or cost of goods sold or property sold. Gross receipts do not include such items as repayment, maturity, or redemption of the principal of a loan, bond, certificate of deposit or similar instrument, the gross principal amount received under a repurchase agreement or other transaction properly characterized as a loan, proceeds from issuance of the taxpayer's own stock or from sale of treasury stock, damages and other amounts received as the result of litigation, property acquired by an agent on behalf of another, tax refunds and other tax benefit recoveries, pension reversions, contributions to capital, or income from forgiveness of indebtedness. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income.	"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, fees royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include, for example, such items as: 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan; 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock; 4) damages and other amounts received as the result of litigation; 5) property acquired by an agent on behalf of another; 6) tax refunds and other tax benefit recoveries; 7) pension reversions; 8) contributions to capital (except for sales of securities by securities dealers); 9) income from forgiveness of indebtedness; or 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.	"Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example: 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument; 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan; 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock; 4) damages and other amounts received as the result of litigation; 5) property acquired by an agent on behalf of another; 6) tax refunds and other tax benefit recoveries; 7) pension reversions; 8) contributions to capital (except for sales of securities by securities dealers); 9) income from forgiveness of indebtedness; or 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

EXHIBIT D