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Via email: vashekon@tax.state.nv.us

Nadia Vasheko
Commerce Tax Manager
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Department of Taxation
Grant Sawyer Office Building
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Re: Comments on Nevada Tax Commission Proposed Draft Regulation Dated September 8, 2015

Dear Ms. Vasheko,

As a follow up to the regulatory workshops concerning the proposed Commerce Tax regulations where Director Contine requested further written comments, we wanted to provide both general and specific comments on the Nevada Tax Commission proposed draft regulation, dated September 8, 2015.

Comments on Draft Regulations of September 8, 2015

The Nevada Commerce Tax draft proposed regulations released on September 8, 2015 ("Draft Regulations"), are a very good start for rulemaking for this complicated new tax. We believe the Draft Regulations should be clarified in several areas and offer the following general and specific comments. Our comments are directed to the first part of these Draft Regulations entitled "Clarifying a taxable business entity and the requirements of a taxable entity". This portion of the Draft Regulations deals with basic definitions, including "taxable entity", "business entity" and "engaging in business in Nevada". We agree that it is important to address these fundamental definitional terms in the Draft Regulations. We believe that the following comments and recommendations are consistent with the statutory language of SB 483 and call for clarifications of various provisions that would aid in tax administration for the Department of Taxation and for the public.

General Comments

1. The Draft Regulations should track the statutory definitions more closely. In particular, although the new defined term "taxable entity" is useful to define the scope of entities and persons that are subject to tax and required to file an annual return, the term should be clarified to include only persons and entities subject to the tax imposed by Section 20 of SB 483, meaning a "business entity" that is exercising the privilege of "engaging in a business in this State", and excluding other persons and specifically the persons or entities listed in Section 4(2) of SB 483.

2. The statutory building blocks of "business entity", "business", "engaging in business" and "engaging in business in this State" should be addressed first, to clarify those terms and to form a sound foundation for the definition of "taxable entity".

3. As a matter of sound tax administration, it would make sense to explicitly exclude small businesses that clearly are not subject to the Commerce Tax from the definition of "taxable entity". We recommend that any business entity with "gross revenue" less than the $4 million exemption amount, determined prior to the adjustments allowed by Section 21 of SB 483 and prior to situsing described in Section 22 of SB 483, should not be a taxable entity and should not be required to file a return. We recognize that Section 20(2) of SB 483 can be read to require any business entity engaging in a business in this State to file a return, but we believe that the Department has sufficient latitude, as part of its authority to prescribe forms, to provide for reasonable exemptions from filing in the interests of sensible tax administration.

4. It would be helpful to describe in more detail the activities, persons or entities that are not included in terms such as "taxable entity", "business" and "business entity", and equally helpful to describe the activities, persons or entities that are not included. In addition, the use of examples to illustrate the basic principles of the tax would greatly aid in tax administration and should be considered.

Specific Comments

1. **Interpretation of "Business" and "Engaging in Business"**. The Draft Regulations state that "engaging in business" has the meaning ascribed to it in Section 6 of SB 483, without further detail. The Draft Regulations also do not interpret the fundamental term "business" as used in Section 3 of SB 483. Although the statutory definitions may be largely self-explanatory, it would be very helpful to provide regulatory interpretation of the scope of the term "business" that is subject to the tax. We recommend that the term "business" should be clarified by a definitional section in the regulations, and specifically that:

(i) "business" should include those activities that are considered to be a "trade or business" as used in federal income tax law, a definition that is familiar to taxpayers;

(ii) "business" should not include investment activities;

(iii) "business" should also not include attribution of business activity from a separate entity in which the person owns an interest (for example, by the ownership of an interest in a corporation, partnership, limited liability company or other entity), without regard to whether the person is involved in the management of such other entity or entities;

(iv) "business" should not include the ownership of real estate for investment located outside Nevada.

We believe that the term "business" as used in the Commerce Tax clearly was intended to encompass all activities attributable to Nevada that constitute a "trade or business" as that term is used in federal tax law. We do not believe that the Commerce Tax was intended to reach investment activities such as the ownership of marketable securities, although the activity of acting as dealer or trader in such securities would fall within the scope of "trade or business" and therefore the definition of "business" in the Commerce Tax. The scope of the term "business" could be illustrated by some simple examples that would be very helpful to the administration of the tax.

We also believe that each entity that is directly engaging in business in Nevada should be subject to the Commerce Tax without regard to the activities of other entities in which it owns an interest, a general principle that is necessary to avoid "pyramiding" of the tax. The other entity, of course, will be subject to the Commerce Tax if it is directly engaging in business in Nevada. This entity-by-entity principle should apply not just to the computation of the tax, but also to the determination of whether an entity or person is engaging in a business and whether any of the exclusions from classification as a business entity in Section 4(2) of SB 483 should apply.

Finally, if a person or entity is not otherwise engaged in business in Nevada, the fact that it owns real property located outside of Nevada for investment should not cause it to be engaged in a business for purposes of the Commerce Tax.

2. **Treatment of Federal Schedule E.** The Draft Regulations, in the definition of "taxable entity", include an entity or person who files federal Schedule C, Schedule E or Schedule F. These schedules are used by individuals and some trusts to report activities from a business that constitutes a trade or business which should be subject to the Commerce Tax if engaged in within Nevada. However, the use of Schedule E for this purpose is overly broad, because federal Schedule E is also used to report income from other entities, including S corporations and partnerships (including various forms of entities taxed as partnerships). Schedule E has four parts:

Part I	Income or Loss from Rental Real Estate and Royalties
Part II	Income or Loss from Partnerships and S Corporations
Part III	Income or Loss from Estates and Trusts
Part IV	Income or Loss from Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

As stated above, the activities of other entities in which an entity or person holds an interest should not be taken into account for purposes of determining whether such entity or person is engaging in business and subject to the Commerce Tax. Partnerships and S corporations may be subject to the Commerce Tax in their own right; estates and trusts may be subject to the Commerce Tax is some circumstances; and REMICs are excluded from the Commerce Tax under Section 4(2)(j) of SB 483.

Consequently, we recommend that the references to Schedule E should be modified to include only the portion of Schedule E relevant to activities conducted by the taxpayer (Part I), and not the activities by other entities the income from which pass through to the taxpayer. Furthermore, rental real estate activity reported on Part I of Schedule E should be taken into account only if the real estate is located in Nevada.

3. **"Engaging in Business in this State".** In contrast to the lack of definition of "business", Section 4 of the Draft Regulations contains a long list of activities that constitute "business in this State" and create tax nexus with Nevada. Section 4 of the Draft Regulations appears to be directed to whether activities that constitute a business have nexus with Nevada for purposes of the Commerce Tax, but the list of activities may also be construed to define what constitutes "business" or "engaging in a business" for purposes of the Commerce Tax. This distinction should be clarified.

With regard to whether a business has sufficient nexus with Nevada to be subject to the Commerce Tax, we recommend consideration of an alternative approach that would treat any business with gross receipts that are sitused to Nevada under Section 22 of SB 483, and therefore taxable as "Nevada gross revenue" as defined in Section 9 of SB 483, as having sufficient nexus. In addition, Section 4 of the Draft Regulations list several activities that, by themselves, do not appear to constitute "engaging in business in this State", and whether or not they create a sufficient Nevada presence for a business entity to be subject to Nevada's tax jurisdiction is doubtful. These activities include:

> (h) holding companies: maintaining a place of business in Nevada or managing, directing, and/or performing services in Nevada for subsidiaries or investee entities;

Comment: a holding company that directly performs services in Nevada for its subsidiaries and receives fees for those services would have taxable Nevada gross receipts, but a "pure holding company" that does not receive management fees from subsidiaries would not have Nevada gross receipts and should not be considered to be "engaging in business" ;

> (l) partners: (A) acting as a general partner in a general partnership which is doing business in Nevada . . .

Comment: a general partnership itself could be a taxable business entity subject to the Commerce Tax, and if the general partner receives fees for managing the partnership, it may also

be engaging in business. However, merely acting as a general partner in an investment partnership without receiving management fees should not constitute engaging in business.

(m) place of business: maintaining a place of business in Nevada;

Comment: if the entity is not otherwise "engaging in business", maintaining an administrative office or mailing address in Nevada should not result in "engaging in business" in Nevada.

(t) telephone listing: having a telephone number that is answered in Nevada;

Comment: if the entity is not otherwise "engaging in business", maintaining a telephone number that is answered in Nevada should not result in "engaging in business" in Nevada.

4. Interpretation of "Business Entity" Definition. We believe that it would be helpful to state the general rule that the Commerce Tax is applied on an entity-by-entity basis and clarify the types of entities that are taxable. The Draft Regulations state that S corporations are included in the list of entities that may be business entities. We recommend that the regulations also state that disregarded entities (for federal income tax purposes) also are treated as separate entities under the Commerce Tax. Many taxpayers may be confused by this point. Business entity as defined in Section 4(a) of SB 483 includes not only the listed types of entities, but "any other person engaged in business". We recommend that the regulations affirmatively state that a person or entity is a "business entity" only if it is "engaged in business". We also recommend that it would helpful to tax administration to explicitly state that a "business entity" can be any type of "person" as defined in the general statutes, including a natural person, estate or trust unless excluded under Section 4(2) or unless not engaged in business.

In addition, we have provided separate comments that address the treatment of trusts under the Commerce Tax. "Business trusts" should be defined to include those trusts governed by NRS Chapter 88A, and other trusts typically are established for investment purposes and are not engaged in business, but would be treated as a taxable business entity if directly engaged in business. Assuming that trusts will be addressed in a separate section of the regulations, a cross-reference should be added.

5. Exclusions from "Business Entity". The Draft Regulations in Section 5 simply state that "taxable entity" does not include entities specifically excluded by Section 4(2) of SB 483. We believe that the exclusions set forth in Section 4(2) of SB 483 are exclusions from the scope of "business entity", which is different from the concept of taxable entity. In addition, we believe that several of the exclusions should be interpreted by regulations, including the following:

Section 4(2)(b): The exclusion for natural persons should be clarified to state that federal Schedule E is taken into account only if the person reports income on Part I of Schedule E and that rental real estate activity reported on Part 1 of Schedule E should be taken into

account only if the real estate is located in Nevada, consistent with our comments above addressed to Schedule E.

Section 4(2)(d): The exclusion for tax exempt entities should be clarified to state that these entities are wholly excluded from the term "business entity" and the Commerce Tax, even if the entities report some "unrelated business taxable income" for federal income tax purposes.

Section 4(2)(l): The exclusion for "passive entities" is complex. We believe that several clarifications would be helpful to both the Department and to taxpayers. These recommendations reference the relevant subsection of SB 483:

(a) Section 14.1(b): Income test for "passive entity" status should exclude income from pass-through entities (including S corp, partnership and disregarded entities – all K-1 income). Alternatively, all income from pass-through entities should be qualifying income for the 90% test (not limited to income from LLCs)

(b) Section 14.1(c): Income for purposes of the "active trade or business" test for "passive entity" status should exclude income from pass-through entities (including S corp, partnership– in other words, all K-1 income) and from disregarded entities.

(c) Section 14.3: Clarify that the "active trade or business" test applies to the activities of the entity and not to the activities of pass-through entities or other entities in which the entity owns an interest (even if the relevant entity may participate in the management of such other entity)

Section 4(2)(m): This exclusion for investment management activities leaves some room for interpretation. We believe that the exemption needs further clarification regarding the scope of the term "intangible investments", which is not fully defined in the statutory language. In particular, "intangible investments" should include interests in other legal entities, including flow through entities such as other trusts, S corporations, partnerships, LLCs, disregarded entities or other legal entities in which a person or entity owns an interest, without regard to whether the person or entity controls or participates in the management of such other entity. Those other entities may be subject to the Commerce Tax in their own right, and the Commerce Tax should be applied on an entity-by-entity basis to avoid pyramiding the tax base and incidence of taxation, which would result in undue complexity and unnecessary duplication of the number of tax returns needed to report the same amount of gross receipts.

6. Definition of "Taxable Entity". We believe that the definition of "taxable entity" should be phrased in terms of entities that are taxable under Section 20(1) of SB 483, which includes "each business entity whose Nevada gross revenue in a taxable year exceeds $4,000,000." If the fundamental terms "business" and "business entity" are well defined, the definition of "taxable entity will follow from those definitions. As stated above, there will be a threshold definition as to whether businesses with less than $4,000,000 of Nevada gross revenue

should be required to file some type of return, and Section 20(2) of SB 483 requires that "each business entity engaging in a business in this State during a taxable year shall . . . file with the Department a report on a form prescribed by the Department". Read literally, this could require an entity with $1.00 of Nevada gross revenue to file a return. However, we believe the delegation of general authority to the Department and the specific authority to prescribe forms, gives the Department ample authority to exempt small business under the $4 million threshold from the annual return requirement. Otherwise, the Department would receive a blizzard of irrelevant filings and the public would be unnecessarily burdened.

We appreciate the Nevada Department of Taxation's consideration of our comment(s) and suggestions. Thank you for your attention in this matter.

Sincerely yours,

Robert E. Armstrong, Esq.

REA/neh

cc: Deonne Contine, Executive Director Department of Taxation (via email: contine@tax.state.nv.us)
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