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Deonne Contine
Executive Director
Nevada Department of Taxation
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Carson City, Nevada 89706
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Re: Comments to Nevada Commerce Tax Regulation

Dear Director Contine,

In follow up to our meeting held on August 4, 2015 with you, Paulina Oliver and Bryan Fernley which we greatly appreciated, this letter is intended to set forth our comments and suggested regulatory language concerning the Nevada Commerce Tax enacted as S.B. 483 for the Nevada Department of Taxation's consideration. As we principally presented in our meeting, a private express trust is a unique concept and one that is frequently misconstrued as some form of legal or business entity. It remains today a form of property ownership. This form of property ownership is confirmed by the only complete definition of "trust" set forth at NRS 132.350.

Nevada Commerce Tax Comments and Proposed Regulations

1. **Section 4:** Clarify that the definition of "business entity" should exclude trusts other than statutory business trusts (chapter 88A business trusts) or trusts engaged in business in Nevada based on the activities of the trust itself.

Statutory Provision

Sec. 4. 1. Except as otherwise provided in subsection 2, "business entity" means a corporation, partnership, proprietorship, limited-liability company, business association, joint venture, limited-liability partnership, business trust, professional association, joint stock company, holding company and any other person engaged in a business.

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Proposed Regulation – Alternative 1

Trusts Considered to be Business Entities. The term “business entity” includes business trusts, but not other trusts, including inter vivos trusts or testamentary trusts, that are described in NRS 132.350. The term “business trust” as used in the definition of business entity means a business trust as defined in NRS Chapter 88A that has filed a certificate of trust with the Secretary of State, or a foreign business trust that is required to file a registration with the Secretary of State prior to transacting business in this State. Trusts other than business trusts are described in NRS 132.350, and include inter vivos trusts, testamentary trusts and other trusts that are not business trusts. For the purposes of these regulations, (i) when reference is made to a “trust” which is not referred to as a “business trust”, the definition provided in NRS 132.350 shall control regardless of whether the trust was formed under the laws of this State or another jurisdiction, and (ii) the term “beneficiary” shall have the same meaning as used in NRS 132.050.

Example (1). Trust A is a business trust formed under NRS Chapter 88A or comparable laws of another state. If Trust A is engaged in business in Nevada within the meaning of Section 3 and Section 6, then Trust A is a business entity for purposes of the Commerce Tax.

Example (2). Trust B is an inter vivos trust created by X, a Nevada resident, to own, maintain and manage investment assets for beneficiaries that are members of X’s family. Trust B is not a business entity for purposes of the Commerce Tax, because Trust B is not a business trust formed under NRS Chapter 88A or comparable laws of another state. Trust B would not be a business entity regardless of whether or not its trustee or trustees, beneficiary or beneficiaries, or trust administrators are residents of Nevada or domiciled in Nevada.

Proposed Regulation – Alternative 2

Trusts Considered to be Business Entities. The term “business entity” includes business trusts and other trusts that are engaged in business in Nevada within the meaning of Section 3 and Section 6, have Nevada gross revenue situated to Nevada pursuant to Section 22 and are not excluded under Section 4(2). The term “business trust” as used in the definition of business entity means a business trust as defined in NRS Chapter 88A that has filed a certificate of trust with the Secretary of State, or a foreign business trust that is required to file a registration with the Secretary of State prior to transacting business in this State. Trusts other than business trusts are described in NRS 132.350,



and include inter vivos trusts, testamentary trusts and other trusts that are not business trusts. For the purposes of these regulations, (i) when reference is made to a “trust” which is not referred to as a “business trust”, the definition provided in NRS 132.350 shall control regardless of whether the trust was formed under the laws of this State or another jurisdiction, and (ii) the term “beneficiary” shall have the same meaning as used in NRS 132.050. The determination of whether a trust is engaged in business in Nevada is made based upon the activities conducted directly by the trust or on behalf of the trust by the trustees, without regard to activities conducted by pass-through entities or other entities in which the trust owns an interest and without regard to whether the trust or any trustee, beneficiary or trust officeholder is a general partner, manager or officer or otherwise controls such other entity or whether the trust reports revenue from such other entity for income tax purposes. Similarly, the situs of the administration of the trust and the choice of law governing the trust in the trust instrument is not relevant in determining whether the trust is engaged in business in Nevada.

Example (1). Trust A is a business trust formed under NRS Chapter 88A or comparable laws of another state. If Trust A is engaged in business in Nevada within the meaning of Section 3 and Section 6, then Trust A is a business entity for purposes of the Commerce Tax. If Trust A is not engaged in business in Nevada within the meaning of Section 3 and Section 6, then Trust A is not a business entity for purposes of the Commerce Tax.

Example (2). Trust B is an inter vivos trust created by X, a Nevada resident, to own, maintain and manage investment assets for beneficiaries that are members of X’s family. Trust B is not engaged in business in Nevada within the meaning of Section 3 and Section 6. Trust B is not a business entity for purposes of the Commerce Tax. Trust B would not be a business entity regardless of whether or not its trustee or trustees, beneficiary or beneficiaries, or trust administrators are residents of Nevada or domiciled in Nevada.

Example (3). Trust B is an inter vivos trust created by X, a Nevada resident, to own, maintain and manage investment assets for beneficiaries that are members of X’s family. In addition to investments such as stocks, bonds and other marketable securities, Trust B owns interests in several entities that are engaged in business in Nevada, including pass-through entities, and the trustees, beneficiaries or trust officeholders of Trust B participate in the management of those entities (as a general partner, manager, officer or similar capacity). However, Trust B itself is not directly engaged in business in Nevada within the meaning of Section 3 and Section 6. Trust B is not a business entity for purposes of the Commerce Tax and is not considered to be engaged in business by reason of the participation of its trustees, beneficiaries or trust officeholders in the management

of entities in which Trust B owns an interest. The entities in which Trust B owns an interest may be business entities that are subject to the Commerce Tax.

Example (4). The facts are the same as in Example 3, except that in addition to its other activities Trust B itself is directly engaged in a business in Nevada within the meaning of Section 3 and Section 6 and has Nevada gross revenue. Trust B is a business entity for purposes of the Commerce Tax, unless Trust B is excluded from the definition of business entity under Section 4(2).

2. **Section 10.5:** Clarify that “pass-through entity” includes entities that are classified as S corporations in addition to entities that are classified as partnerships or disregarded entities for federal income tax purposes.

Statutory Provision

Sec. 10.5. “Pass-through entity” means an entity that is disregarded as an entity for the purposes of federal income taxation or is treated as a partnership for the purposes of federal income taxation.

Proposed Regulation

“Pass-through entity” defined.

“Pass-through entity” means an entity that (1) is disregarded as an entity for the purposes of federal income taxation, (2) is treated as a partnership for the purposes of federal income taxation, or (3) is classified as an S corporation for purposes of federal income taxation. Accordingly, the term pass-through entity may include a partnership, limited partnership, limited liability company, limited liability partnership, corporation or other entity that is classified as a disregarded entity, partnership or S corporation for federal income tax purposes.

3. **Section 14:** Clarify the application of the “passive entity” definition:
 - (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 and disregarded entities – in other words, all K-1 income).

- (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)

Statutory Provision

Sec. 14. 1. For the purposes of this chapter, a business is a “passive entity” only if:

- (a) The business is a limited-liability company, general partnership, limited-liability partnership, limited partnership or limited-liability limited partnership, or a trust, other than a business trust;
- (b) During the period for which the gross revenue of the business entity is reported pursuant to section 20 of this act, at least 90 percent of the business entity’s federal gross income consists of the following income:
- (1) Dividends, interest, foreign currency exchange gains, periodic and nonperiodic payments with respect to notional principal contracts, option premiums, cash settlements or termination payments with respect to a financial instrument, and income from a limited-liability company;
- (2) Capital gains from the sale of real property, gains from the sale of commodities traded on a commodities exchange and gains from the sale of securities; and
- (3) Royalties, bonuses or delay rental income from mineral properties and income from other nonoperating mineral interests; and
- (c) The business entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business.

2. As used in paragraph (b) of subsection 1, the term “income” does not include any:

- (a) Rent; or
- (b) Income received by a nonoperator from mineral properties under a joint operating agreement if the nonoperator is a member of an affiliated group and another member of that group is the operator under that joint operating agreement.

3. For the purposes of paragraph (c) of subsection 1:

- (a) Except as otherwise provided in this subsection, a business entity is “conducting an active trade or business” if:
- (1) The activities being carried on by the business entity include one or more active operations that form a part of the process of earning income or profit, and the business entity performs active management and operating functions; or

- (2) Any assets, including, without limitation, royalties, patents, trademarks and other intangible assets, held by the business entity are used in the active trade or business of one or more related business entities.
- (b) The ownership of a royalty interest or a nonoperating working interest in mineral rights does not constitute the conduct of an active trade or business.
- (c) The payment of compensation to employees or independent contractors for financial or legal services reasonably necessary for the operation of a business does not constitute the conduct of an active trade or business.
- (d) Holding a seat on the board of directors of a business entity does not by itself constitute the conduct of an active trade or business.
- (e) Activities performed by a business entity include activities performed by persons outside the business entity, including independent contractors, to the extent that those persons perform services on behalf of the business entity and those services constitute all or any part of the business entity's trade or business.

Proposed Regulation

“Passive entity” defined.

(1) In General. A “passive entity” is excluded from the definition of business entity by Section 4(2)(l) and therefore is not subject to the Commerce Tax. For the purposes of this chapter, a business is a “passive entity” only if the entity satisfies (i) an organizational test, (ii) a passive income test that requires at least 90 percent of the entity's federal gross income to consist of specified categories of passive investment income, and (iii) an active trade or business income test that requires no more than 10 percent of the entity's federal gross income to be received from conducting an active trade or business. These tests are applied for each taxable year of the entity.

(2) Organizational Test. An entity satisfies the organizational test for “passive entity” status if the entity is a limited-liability company, general partnership, limited-liability partnership, limited partnership or limited-liability limited partnership, or a trust, other than a business trust. Corporate entities may also qualify for “passive entity” status if the passive income and active trade or business income tests are satisfied.

(3) Passive Income Test. An entity satisfies the passive income test for “passive entity” status if during the period for which the gross revenue of the business entity is reported pursuant to section 20 of this act, at least 90 percent of the business entity's federal gross income consists of the following income:

- (a) Dividends, interest, foreign currency exchange gains, periodic and nonperiodic payments with respect to notional principal contracts, option premiums, cash settlements or termination payments with respect to a financial instrument, and income from a limited-liability company;
- (b) Capital gains from the sale of real property, gains from the sale of commodities traded on a commodities exchange and gains from the sale of securities; and
- (c) Royalties, bonuses or delay rental income from mineral properties and income from other nonoperating mineral interests.

For purposes of this passive income test, “income” does not include any (i) rent, or (ii) income received by a nonoperator from mineral properties under a joint operating agreement if the nonoperator is a member of an affiliated group and another member of that group is the operator under that joint operating agreement. The passive income test is applied only to the federal gross income received directly by the entity (the “Upper Tier Entity”) and not to the Upper Tier Entity’s distributive or proportionate share of federal gross income reported to the Upper Tier Entity by any pass-through entity (a “Lower Tier Entity”) in which it owns an interest (without regard to whether the Upper Tier Entity has management rights or control of the Lower Tier Entity).

(4) Limitation on Income from Conducting an Active Trade or Business. An entity satisfies the active trade or business income test for “passive entity” status if the business entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business. A business entity is “conducting an active trade or business” for purposes of this test if:

- (a) The activities being carried on by the business entity include one or more active operations that form a part of the process of earning income or profit, and the business entity performs active management and operating functions; or
- (b) Any assets, including, without limitation, royalties, patents, trademarks and other intangible assets, held by the business entity are used in the active trade or business of one or more related business entities.

For purposes of determining whether an entity is engaged in an active trade or business, (i) the ownership of a royalty interest or a nonoperating working interest in mineral rights does not constitute the conduct of an active trade or business; (ii) the payment of compensation to employees or independent contractors for financial or legal services reasonably necessary for the operation of a business does not constitute the conduct of an active trade or business; and (iii) holding a seat on the board of directors of a business

entity does not by itself constitute the conduct of an active trade or business. The active trade or business income test is applied only to the income received directly by an Upper Tier Entity and not to the Upper Tier Entity's distributive or proportionate share of income reported to the Upper Tier Entity by any Lower Tier Entity in which the Upper Tier Entity owns an interest (without regard to whether the Upper Tier Entity has management rights or control of such Lower Tier Entity), and the business activity of any Lower Tier Entity is not attributed to the Upper Tier Entity owning an interest in the Lower Tier Entity. For purposes of determining whether an entity is engaged in an active trade or business, activities performed by a business entity include activities performed by persons outside the business entity, including independent contractors, to the extent that those persons perform services on behalf of the business entity and those services constitute all or any part of the business entity's trade or business.

4. **Section 20.2:** Clarify that the annual return requirement does not apply to trusts that are not engaged in business and other entities that are excluded from the definition of "business entity", for example, passive entities

Statutory Provision

Sec. 20. 2. Each business entity engaging in a business in this State during a taxable year shall, on or before the 45th day immediately following the end of that taxable year, file with the Department a report on a form prescribed by the Department. The report required by this subsection must include such information as is required by the Department. A business entity shall remit with the return the amount of commerce tax due pursuant to subsection 1.

Proposed Regulation

Returns.

(1) Except as provided in subsection (2), each business entity engaging in a business in this State during a taxable year shall, on or before the 45th day immediately following the end of that taxable year, file with the Department a report on a form prescribed by the Department, including such information as is required by the Department. A business entity shall remit with the return the amount of Commerce Tax due pursuant to Section 20.2.

(2) Entities that are not subject to the Commerce Tax by reason of not being classified as business entities under Section 4(1), being excluded from the definition of business entity under Section 4(2), or having Nevada gross revenue of less than \$4 million during the taxable year are not required to file a Commerce Tax annual return.

Example (1). C is a corporation engaged in business in Nevada with Nevada gross revenue of \$2 million during the taxable year. C is not required to file a Commerce Tax return for the taxable year.

Example (2). Alternative A. Trust D is an inter vivos trust that is not a business trust. Trust D is not required to file a Commerce Tax return.

Example (2). Alternative B. Trust D is an inter vivos trust that is not engaged in business in Nevada as described in Reg. Section xx. Trust D is not required to file a Commerce Tax return.

Example (3). Corporation E is a nonprofit charitable organization that qualifies as a tax-exempt organization under 26 U.S.C. 501(c)(3). Because Corporation E is excluded from the definition of business entity under Section 4(2), Corporation E is not required to file a Commerce Tax return. The fact that Corporation E may have substantial unrelated business taxable income that is taxable for federal income tax purposes is not taken into account.

Example (4). Partnership P is a passive entity within the meaning of Section 14 for a taxable year. Therefore, Partnership P is not a business entity for the taxable year by reason of Section 4(2)(1). Partnership P is not required to file a Commerce Tax return for the taxable year.

5. **Section 21.1(p):** Clarify that “dividends and distributions from corporations” includes distributive share of income from S corporations) and similar items (e.g., subpart F income)

Statutory Provision

Sec. 21. 1. In computing the commerce tax owed by a business entity pursuant to this chapter, the business entity is entitled to deduct from its gross revenue the following amounts, to the extent such amounts are included in gross revenue of the business entity:

* * *

- (p) Dividends and distributions from corporations, and distributive or proportionate shares of receipts and income from a pass-through entity.

Proposed Regulation

Deductions from Gross Revenue

Section 21 provides that in computing the Commerce Tax, a business entity is entitled to deduct from its gross revenue the following amounts (to the extent such amounts are included in gross revenue of the business entity):

* * *

(p) dividends and distributions from corporations, and distributive or proportionate shares of receipts and income from a pass-through entity. For purposes of this subsection, subpart F income, distributive shares of income or revenue from an entity treated as an S corporation for purposes of federal income taxation, and similar amounts required to be included in the income of a shareholder of a corporation (to the extent not deducted as shares of receipts and income from a pass-through entity) are included in the term “dividends and distributions from corporations”.

6. **Section 4.2(m):** Clarify the exclusion from “business entity” status for certain investment management entities to explicitly cover trusts that own, maintain and manage investments for their own account, and management companies such as private trust companies that manage family investment entities and multiple trusts or similar entities. Clarify the definition of “intangible investments” to include interests in other entities in addition to stock (for example, partnerships, LLCs and similar entities) and add a de minimis rule for tangible property located in Nevada and customarily included in investment portfolios (for example, metals, commodities, real estate not actively managed). In addition, certain tangible property such as art, antiques or collectibles that are not used to generate revenue should be permitted to be owned in Nevada without loss of the 4.2(m) exclusion.

Statutory Provision

Sec. 4. 2. “Business entity” does not include: * * *

(m) A person whose activities within this State are confined to the owning, maintenance and management of the person’s intangible investments or of the intangible investments of persons or statutory trusts or business trusts registered as investment companies under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq., as amended, and the collection and distribution of the income from such investments or from tangible property physically located outside this State. For the purposes of this paragraph, “intangible investments” includes, without limitation, investments in stocks, bonds, notes and other debt obligations,

including, without limitation, debt obligations of affiliated corporations, real estate investment trusts, patents, patent applications, trademarks, trade names and similar types of intangible assets or an entity that is registered as an investment company under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq.

Proposed Regulation

Exclusion for Certain Investment Management Activities. Section 4(2)(m) provides that persons whose activities within this State are confined to the owning, maintenance and management of the person's intangible investments, or of the intangible investments of other persons, or of persons or statutory trusts or business trusts registered as investment companies under the Investment Company Act of 1940, and the collection and distribution of the income from such investments or from tangible property physically located outside this State, are excluded from the definition of business entity. The exclusion from treatment as a business entity set forth in Section 4(2)(m) applies to persons that own, maintain and manage intangible investments for their own accounts and well as persons that own, maintain and manage the intangible investments of one or more other persons. Persons who qualify under Section 4(2)(m), include, but are not limited to persons and entities that own, maintain and manage intangible investments, including interests in pass-through entities and other entities (including corporate stock, interests in partnerships or limited liability companies or similar evidences of ownership), including entities that are disregarded entities for federal income tax purposes. Those other entities may directly own tangible property held for investment purposes (for example, art, commodities and real estate) and may engage in business in Nevada without affecting the character of the interests as intangible investments.

Example (1). Trust A is an inter vivos trust that is not a business trust. The trustees of Trust A own, maintain and manage the intangible assets of Trust A, including interests in pass-through entities and corporations that are engaged in business in Nevada. Trust A is described in Section 4.2(m) and is not a business entity for purposes of the Commerce Tax.



We look forward to the release of the first draft of the commerce tax regulations, our participation in the development of the subject regulations and our further discussions concerning this matter. Please do not hesitate to contact me if you or your representatives have further inquiries concerning our comments and proposed suggested regulatory language.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Robert E. Armstrong', written over a printed name.

Robert E. Armstrong

REA/neh

cc: Bryan Fernley, Principal Deputy Legislative Counsel (bryan.fernley@lcb.state.nv.us)
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