OFFICE OF CHIEF COUNSEL
DEPT. 281061
HARRISBURG, PA 17128-1061

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE

PHONE: 717-787-1382
FAX: 717-772-1459

October 1, 1997

John R. McGinley, Jr.
Chairman
Independent Regulatory Review Commission
333 Market Street, 14th Floor
Harrisburg, PA 17101

Original: 1882
cc: CAT
RMS
MSW
AMB

Re: Public Comment - 15-381
Stradley, Ronon, Stevens and Young, LLP - Z. Alexander

Dear Chairman McGinley:

In accordance with section 5(c) of the Regulatory Review Act (71 P.S. § 745.5(c)), please find enclosed one public comment received by the Department on September 26, 1997, relating to Regulation 15-381, Definitions; Net Profits and Regulated Investment Companies.

If you have any questions regarding this matter, please contact me at (717) 787-1382.

Sincerely,

Anita M. Doucette

Anita M. Doucette
Regulatory Coordinator

Enclosure

AMD:tlch (sp)

RECEIVED
97 OCT -1 PM 2:32
INDEPENDENT REGULATORY REVIEW COMMISSION

STRADLEY RONON STEVENS & YOUNG, LLP
ATTORNEYS

2600 One Commerce Square
Philadelphia, Pennsylvania 19103-7098
(215) 564-8000
Fax (215) 564-8120

DEPARTMENT OF REVENUE
RECEIVED
SEP 26 1997
OFFICE OF CHIEF COUNSEL

September 26, 1997

Via Telecopy (717) 772-1459 and U.S. Express Mail
Ms. Anita M. Doucette
Office of Chief Counsel
Pennsylvania Department of Revenue
Department 281061
Harrisburg, PA 17128-1061

Re: Notice of Proposed Rulemaking In August 30, 1997 Pennsylvania Bulletin With Respect to Reg. §§103.12 and 155.30 - Definition of Net Profits and Franchise Tax on Regulated Investment Companies

Dear Ms. Doucette:

I would like to take this opportunity to comment on and express opposition to certain of the proposed changes to regulations published in the August 30, 1997 edition of the Pennsylvania Bulletin, and, in particular, the proposed changes to Reg. §103.12 dealing with "net profits" and Reg. §155.30 dealing with the capital stock/franchise tax on regulated investment companies. This firm represents numerous regulated investment companies currently paying the alternate capital stock/franchise tax which would be affected by the proposed changes to these regulations. It is submitted that the proposed changes not only violate the statutory provisions of Pennsylvania law they purport to interpret, but constitute bad tax policy that will discourage growth in this business sector.

Overview

The proposed changes to the regulations are apparently designed to affect the taxation of regulated investment companies (also known as "mutual funds"). The principle Pennsylvania business tax on regulated investment companies is the alternate capital stock/franchise tax set forth in the Pennsylvania Tax Reform Code (the "TRC") at §602(f). Section 602(f) provides as follows:

> Every domestic corporation and every foreign corporation (i) registered to do business in Pennsylvania; (ii) which maintains an office in Pennsylvania; (iii) which has filed a timely election to be taxed as a regulated investment company with the Federal government; and (iv) which duly qualifies to be taxed as a regulated investment company under the provisions of the Internal Revenue Code of 1954, as amended, shall be taxed as a regulated investment company and shall be subject to the capital stock or franchise tax imposed by section 602, in either case, for the privilege of having an office in Pennsylvania, which tax shall be computed pursuant to the provisions of this subsection in lieu of all other provisions of this section 602. The tax shall be in an amount which is the greater of three hundred dollars ($300) or the sum of the amounts determined pursuant to clauses (1) and (2):
>
> (1) The amount determined pursuant to this clause shall be seventy-five dollars ($75) times that number which is the result of dividing the net asset value of the regulated investment company by one million, rounded to the nearest multiple of seventy-five dollars ($75). Net asset value shall be determined by the adding the monthly net asset values as of the last day of each month during the taxable period and dividing the total sum by the number of months involved. Each such monthly net asset value shall be the actual market value of all assets owned without any exemptions or exclusions, less all liabilities, debts and other obligations.
>
> (2) The amount determined pursuant to this clause shall be the amount which is the result of multiplying the rate of taxation applicable for purposes of the personal income tax during the

same taxable year times the apportioned undistributed personal income tax income of the regulated investment company. For the purpose of this clause:

(A) Personal income tax income shall mean income to the extent enumerated and classified in section 303.

(B) Undistributed personal income tax income shall mean all personal income tax income other than personal income tax income undistributed on account of the capital stock or foreign franchise tax, less all personal income tax income distributed to shareholders. At the election of the company, income distributed after the close of a taxable year, but deemed distributed during the taxable year for Federal income tax purposes, shall be deemed distributed during that year for purposes of this clause. If a company in a taxable year has both current income and income accumulated from a prior year, distributions during the year shall be deemed to have been made first from current income.

(C) Undistributed personal income tax income shall be apportioned to Pennsylvania by a fraction, the numerator of which is all income distributed during the taxable year to shareholders who are resident individuals, estates or trusts and the denominator of which is all income distributed during the taxable period. Resident trusts shall not include charitable, pension or profit-sharing, or retirement trusts.

(D) Personal income tax income and other income of a company shall each be deemed to be either distributed to shareholders or undistributed in the proportion each category bears to all income received by the company during the taxable year.

Thus, the tax is comprised of two components, one computed on the basis of $75 per million of net asset value, and one computed on the basis of "apportioned undistributed personal income tax income." The proposed regulations apparently relate to the undistributed personal income tax income portion of the tax.

The statute provides that "personal income tax income" means income to the extent enumerated and classified in §303 of the TRC. Those classes of income consist of (i) compensation, (ii) net profits, (iii) net gains from the disposition of property, (iv) net gains or income from or in the form of rents, royalties, patents and copyrights, (v) dividends, (vi) interest, (vii) gambling and lottery winnings other than prizes of the Pennsylvania State Lottery, and (viii) net gains derived through estates.

At present, regulated investment companies that are subject to the tax categorize their personal income tax income as "net profits" and that categorization has, as discussed below, been established as correct by both the Board of Finance and Revenue and the Board of Appeals in several cases addressing the issue, and has been accepted by the Department of Revenue as correct in the settlement of corporate tax reports of regulated investment companies. The proposed changes to the regulations appear to attempt to change this result by treating regulated investment companies as individuals (rather than as corporations) and to require that personal income tax income only be comprised of the categories of income consisting of interest, dividends and gains.

The Proposed Regulatory Changes Do Not Fairly or Legally Interpret the Statute

The attempt to artificially classify regulated investment companies as individuals is clearly inconsistent with the statutory provisions the regulations purport to interpret. The taxing statute in question -- the capital stock/franchise tax -- only applies to taxpayers classified as corporations. In order for such taxpayers to be subject to the tax, they must be "doing business" in Pennsylvania.

Regulated investment companies subject to the capital stock/franchise tax must therefore be engaged in business activities in Pennsylvania.[1] As such, their income is necessarily characterized as "net profits."

[1] For federal income tax purposes, Internal Revenue Code §852 contemplates that regulated investment companies fall within the scope of taxation as corporations and therefore compute their taxable income taking into account appropriate deductions for expenses.

Section 303(a)(2) of the TRC (72 P.S. §7303(a)(2)) defines net profits as follows:

> Net profits. The net income from the operation of a business, profession, or other activity, after provision for all costs and expenses incurred in the conduct thereof, determined either on a cash or accrual basis in accordance with the accepted accounting principles and practices but without deduction of taxes based on income.

As indicated above, the Board of Finance and Revenue has established that the appropriate characterization of income of a regulated investment company for purposes of computing "undistributed personal income tax income" is net profits and further determined that it is appropriate that a deduction be permitted for business expenses. That determination was set forth in the conclusions of law in numerous cases and was first expressed in the Interlocutory Order ("Order") mailed on December 16, 1994, by the Board of Finance and Revenue, Docket No. 25416, in In Re: Valley Forge Fund, Inc.[2]

The Board of Finance and Revenue concluded in Valley Forge Fund, Inc. that:

> ...[T]he "personal income tax income" to be used in calculating the second portion of ...[a regulated investment company's] capital stock tax is...[the regulated investment company's] net profit from the operation of its business. Not allowing the deduction of business expenses, in effect, means using gross income in the franchise tax calculation. The definitions of "income" and "net profits" applied to the statute at 72 P.S. §7602(f) does not support the use of gross income in this calculation. See 72 P.S. §7301(g); also see 72 P.S. §7303(2). Therefore,...[a regulated investment company's] personal income tax income portion of its capital stock tax is zero....

Of course, to the extent that a regulated investment company does not distribute all of its income, it will have a liability for the tax on apportioned undistributed personal income tax income.

---

[2] It should be noted that the Commonwealth of Pennsylvania (through the Department of Revenue) withdrew its Commonwealth Court appeal of the Order.

On the basis of the foregoing, it is submitted that the proposed changes to the regulations, consisting, in particular, to the proposed changes reflected by the addition of subsection (c) to regulation 103.12 and all of the proposed changes to regulation 155.30, do not represent a fair or legal interpretation of the statute.

It should also be noted that most of the incorporated regulated investment companies subject to §602(f) of the TRC are foreign corporations. Thus, in order to be taxable in the Commonwealth at all, those entities must be doing business in the Commonwealth. If so, as indicated above, the appropriate category of income for purposes of determining personal income tax income is necessarily net profits.

By attempting to characterize regulated investment companies as individuals, the proposed regulations purport to establish that such entities are not doing business in the Commonwealth (and are not therefore deriving "net profits"). It is submitted that if such is the case, the taxpayers are not subject to Pennsylvania business taxes at all and have no tax filing requirements in the Commonwealth. That is because most if not all of such regulated investment companies have no tangible assets nor employees. The only assets are intangibles which, under these circumstances, would likely have as their situs the state of the taxpayers' incorporation. That being the case, there is no taxable nexus to Pennsylvania. Thus, the proposed changes to the regulations put the Commonwealth at risk for losing the revenue currently generated by the tax.

The Proposed Regulations Are Bad Tax Policy

Perhaps as important as the legal issues discussed above is the fact the taxation of regulated investment companies, and the position of the Commonwealth represented by the proposed changes to the regulations, constitutes bad tax policy. Pennsylvania is virtually the only state that imposes any significant amount of corporate level taxes on regulated investment companies. Regulated investment companies are provided with tax favored (flow-through) status for federal income tax purposes and in nearly every state (including New York, New Jersey, Delaware and Maryland) because they facilitate a strong social purpose by encouraging investment and enabling investors to achieve professional management of their assets and diversification of risk.[3]

Taxation of regulated investment companies in Pennsylvania creates a chilling environment for such business. The management, distribution and administrative activities associated with the operation of regulated investment companies are significant and require the employment of substantial numbers of people. It is submitted that this type of service business is precisely the type of business that the Commonwealth should be trying to attract.

* * *

As discussed above, there are compelling legal and policy reasons why the Department of Revenue should withdraw the proposed changes to the regulations discussed herein.

Thank you for the opportunity to provide input on this matter. If you have any questions or comments, please do not hesitate to contact me.

Very truly yours,

Zachary P. Alexander

224988.1

[3] Shareholders are generally taxable on the income from regulated investment companies.

Original: 1882
McGinley
cc: Smith
Sandusky
Legal

Sample Capital Stock Franchise Tax Calculation of a Regulated Investment Company
72 P.S. §7602(f)

Assumptions

Monthly average net asset value	$ 750,000,000
Undistributed income	8,000,000
Expenses	8,000,000
Franchise tax (included in expenses)	150,000
Income distributed to PA shareholders	9,000,000
Income distributed to all shareholders	25,000,000

Statutory Formula 72 P.S. §7602(f)

Tax = ((monthly average net asset value / 1,000,000) X $75) +
(((undistributed personal income tax income - capital stock franchise tax)
(income distributed to PA shareholders / income distributed to all shareholders))
X personal income tax rate)

Department of Revenue calculation (undistributed income classified within the 8 classes of income)

Tax = ((750,000,000 / 1,000,000) X $75) + (((8,000,000 - 150,000)
(9,000,000 / 25,000,000)) X .028)
= (750 X $75) + ((7,850,000 X .360) X .028)
= 56,250 + (2,826,000 X .028)
= 56,250 + 79,128
= 135,378

Stradley Ronon calculation (all undistributed income classified as net profits)

Tax = ((750,000,000 / 1,000,000) X $75) + (((0 - 150,000)
(9,000,000 / 25,000,000)) X .028)
= (750 X $75) + ((0 X .360) X .028)
= 56,250 + (0 X .028)
= 56,250 + 0
= 56,250

Pennsylvania Lowers Its Franchise Tax on Regulated Investment Companies

JOSEPH C. BRIGHT, JR.

Substantial Change

The Pennsylvania General Assembly has made a substantial change in the calculation of the corporate taxes imposed on regulated investment companies. The result will be a considerably lower tax burden, which will remove in large part what used to be a significant disincentive for a regulated investment company to locate in Pennsylvania.

Regulated investment companies can be formed as corporations, trusts or partnerships. In Pennsylvania, the tax treatment of such a company varies considerably, depending on the form chosen. The recent change affects those regulated investment companies in corporate form.

Two Principal Taxes

Pennsylvania imposes two principal taxes on corporations: the Corporate Net Income Tax and the Capital Stock or Foreign Franchise Tax. The Corporate Net Income Tax takes as its base federal taxable income. In the case of a regulated investment company, the base is after any deduction for distributions to shareholders. Consequently, for almost all regulated investment companies, the CNI Tax is immaterial.

Apportionment Option

The Capital Stock and Franchise Taxes are imposed on domestic and foreign corporations respectively. The base of each tax is capital stock value (largely the equivalent of net worth), to which the rate of ten mills or one percent is applied after such allocation and apportionment as may be applicable. Under prior law, a regulated investment company was entitled to one of two apportionment options. Either the corporation could elect a flat apportionment of ten percent of its capital stock value, or it could use a hybrid apportionment formula with a numerator of sales to Pennsylvania investors plus sales of portfolio securities through Pennsylvania brokers over a denominator of all sales in both categories.

New Tax Calculation

Act 102 of December 19, 1985 eliminates the two previous apportionment elections and substitutes for them a tax calculation which is the sum of two components. The first component is $75 times each million dollars of net asset value determined by a monthly average. The second component consists of the amount which is the result of multiplying the rate of tax applicable for purposes of Pennsylvania's Personal Income Tax times the apportioned undistributed personal income tax income of the company.

Personal Income Tax Relationship

Personal income tax income means income taxable under the Personal Income Tax. Undistributed personal income tax income is essentially the equivalent of the expenses of the company, since all other income will in all likelihood be distributed. Such undistributed income is apportioned to Pennsylvania by a fraction, the numerator of which is all income distributed during the taxable year to shareholders who are resident individuals, estates or trusts and the denominator of which is all income distributed during the taxable period. The Pennsylvania resident trust does not include charitable, pension or profit sharing or retirement trusts.

Economic Effect

The economic effect is to tax at the personal income tax rate that portion of the income of the company used for expenses which is attributable to Pennsylvania investors. The statute puts the Commonwealth on an equal footing with respect to Pennsylvania investors who invest through regulated companies as compared to those who invest their own funds directly, since investors who invest their own funds directly are taxed on a gross receipts basis and cannot deduct expenses.

[cont'd on p.8]

JOSEPH C. BRIGHT, JR. is a partner in the law firm of Drinker, Biddle & Reath in Philadelphia, Pennsylvania. He received his B.A. from Harvard College and his J.D. from the University of Pennsylvania. He was formerly Chief Counsel for the Pennsylvania Department of Revenue, and recently was the draftsman for Act 102 of December 19, 1985, discussed in this article.

LAW OFFICES
WOLF, BLOCK, SCHORR AND SOLIS-COHEN LLP
TWELFTH FLOOR PACKARD BUILDING
111 SOUTH 15TH STREET
PHILADELPHIA, PA 19102-2678
(215) 977-2000
FACSIMILE: (215) 977-2334

JOSEPH C. BRIGHT
DIRECT DIAL: (215) 977-2022
FACSIMILE: (215) 977-2740
E-MAIL: JBRIGHT@WOLFBLOCK.COM

ORIGINAL: 1882
MCGINLEY
COPIES: Tyrrell
Sandusky
Legal

November 11, 1998

Charles A. Tyrrell, Jr.
Regulatory Analyst
Independent Regulatory Review Commission
Commonwealth of Pennsylvania
333 Market Street, 14th Floor
Harrisburg, PA 17101

Re: ***Letter of December 9, 1997***

Dear Mr. Tyrell:

In case you did not find it on the New Jersey Home Page, I enclose a copy of the proposed rulemaking we discussed.

Very truly yours,

J.C. Bright

Joseph C. Bright
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

Enclosure
JCB:jt

DSC:600756.1

TREASURY-TAXATION
DIVISION OF TAXATION

Gross Income Tax
Partnerships; Net Profits from Business

ORIGINAL: 1882
MCGINLEY
COPIES: Tyrrell
Sandusky
Legal

Proposed Regulation: N.J.A.C. 18:35-1.3 (Partnerships and Partners)
Proposed Regulation N.J.A.C. 18:35-1.1 (Net Profits from Business)

Authorized By: Robert K. Thompson, Acting Director, Division of Taxation

Authority: N.J.S.A. 54A:9-17(a) and 54:50-1.
Proposal Number: PRN 1998

Submit comments by October 21, 1998 to:
Nicholas Catalano
Chief, Tax Services
Division of Taxation
50 Barrack Street
P.O. Box 269
Trenton, NJ 08646-0269

The agency proposal follows:

Summary

The proposed new rules address the treatment of net profits from business under N.J.S.A. 54A:5-1(b), and partners and partnerships under N.J.S.A. 54A:5-1(k) . The proposal deletes and replaces N.J.A.C. 18:35-1.1 (Net Profits from Business) and 1.3 (Partnerships and Partners). The proposed new rules are intended to simplify income reporting. The regulations address controversies which have existed since the enactment of the Gross Income Tax Act surrounding the proper interpretation of these sections, and resolve those controversies in a manner that will benefit most taxpayers. The proposed rules are consistent with the ruling of the New Jersey Supreme Court in Smith v. Director, Division of Taxation, 108 N.J. 19, 527 A. 2d 843 (1987), and the Appellate Division decision in Sabino v. Director, Division of Taxation, 296 N.J. Super 269 (A.D., 1996), reversing and remanding 14 N.J. Tax 501 (Tax Ct. 1995).

The proposed regulations are consistent with the structure of the Gross Income Tax Act. The Act establishes sixteen categories of income. Some of those categories are taxed on a gross basis without regard to associated costs, and some are taxed on a net basis, taking associated costs into account. Net profits from business and distributive share of partnership income are both net categories of income. The proposal expands taxpayers' ability to net income and expenses in these two categories. At the same time, the proposed regulations do not impinge upon the Legislature's goal of minimizing tax loopholes under the Income Tax Act. Losses still may not be netted against income from other categories, or carried from one year to the next. Costs and expenses may only be deducted if they are incurred for business purposes.

In these changes for both proposed rules, The Division of Taxation has promoted three of the Legislature's original goals when it enacted the Gross Income Tax Act. First, symmetry: business income is taxed similarly, whether earned by a partner or by a sole proprietor. Second, conformity: characterization of the business entity earning the income for Gross Income Tax purposes conforms to the characterization for federal income tax purposes. Third, simplicity: business income and loss is no longer separated into different categories.

This proposal supersedes the proposed regulations published in the New Jersey Register on March 17, 1997, because the Director decided to revisit his approach to the entire subject of business income.

Net Profits From Business

Proposed new rule N.J.A.C. 18:35-1.1 sets forth the manner in which net profits from business shall be determined for purposes of N.J.S.A. 54A:5-1(b). Sole proprietors who conduct more than one trade or business must report their net profit or loss from each trade or business on a net consolidated basis. All other income of the taxpayer that is not directly attributable to the sole proprietor's business(es) must be included in other gross income tax categories in accordance with its character.

The new regulation represents a revised interpretation of the requirements of N.J.S.A. 54A:5-1(b). All business income will be reported in one category on the taxpayer's return. The Division will not require business income to be reported in categories according to its character or nature (e.g., rental, interest, etc.). Accordingly, interest, dividends, rental income, income from royalties, patents, and copyrights, and gain or loss from the sale, exchange or other disposition of property are all treated as business income, without regard to character, if derived by a taxpayer in the conduct of a trade or business. As a result, the Division will not distinguis income gained in the ordinary course of business from income gained outside the ordinary course of business. A distinction must still be drawn, however, between income that is personal to the taxpayer and income that is due to the conduct of the business. The proposal creates symmetry in the treatment of the different taxpayer entities, because income is netted in the same manner whether it is earned or received from a sole proprietorship, partnership, S corporation, or estate or trust. However, distributive share of income or loss from a partnership, S corporation, or estate or trust must still be reported separately according to its character.

The proposed new rule does not define the term "trade or business". The term as used in the new rules continues to encompass those activities conducted by a taxpayer with continuity and regularity for the primary purpose of realizing income or profit and characterized as trade or business activities for Federal income tax purposes. See Comm'r v. Groetzinger, 480 U.S. 23 (1987); Walsh v. Taxation Div. Director, 4 N.J. Tax 107 (Tax Ct. 1982); Applestein v. Director, Division of Taxation, 5 N.J. Tax 73 (Tax Ct. 1982) aff'd 6 N.J. Tax 347 (App. Div. 1984); Marrinan v. Division of Taxation, Director, 10 N.J. Tax 542 (Tax Ct. 1989), Gilligan v. Director, Division of Taxation, 11 N.J. Tax 414 (Tax Ct. 1991). Under the proposed net profits from business regulation, a taxpayer who "qualifies for and reports as a trade or business for federal income tax purposes" would report as a business for New Jersey tax purposes. This requirement conforms the taxpayer's taxable entity at the state level to the taxable entity chosen for federal income tax purposes. This approach will simplify accounting and reporting for taxpayers.

Treatment of losses is affected by the netting of all business income within a single category. Losses within the business may be netted against gains in the same year regardless of character, so long as both are generated by the business in furtherance of the business enterprise. Liberalizing the loss rules in this manner will allow businesses to use losses to offset income of a different character or nature within the business, a practice that was not permitted under the Division's previous interpretation. Still, as in the past, and consistent with the Gross Income Tax Act, losses may not be carried from one year to the next.

The proposed regulation defines deductible ordinary business costs or expenses. Business costs and expenses are deductible as long as they meet all four of the following: (1) incurred primarily and directly in the pursuit of the business's income; (2) incurred as a common and accepted practice in that field of business; (3) required for and appropriate to the intended business purpose; and (4) reasonable in amount in relation to the intended business purpose. An expenditure that does not meet all four of these criteria is not deductible in determining net profit from business. Costs and expenses incurred by the business that meet this standard are deductible business expenses.

The proposed regulation represents the Director's attempt to explicate and interpret the New Jersey's Supreme Court holding in Smith, supra, that only ordinary expenses are deductible, as reiterated by the Appellate Division in Sabino, supra. The regulation still incorporates the overall methods of accounting allowed for federal income tax purposes. However, The Division is not adopting all of the specific federal income tax rules regarding deductible business costs and expenses. Rather, federal principles and experience inform the substance of the four-part standard. While the proposed regulation does not incorporate the specific provisions for deductibility under Internal Revenue Code Section 162, it follows the Code's underlying logic. The Legislature empowered the Director to make rules to enforce the income tax in N.J.S.A. 54A:9-17. The proposed standard is within the sound and reasonable exercise of the Director's discretion.

Partners and Partnerships

The proposed partnership regulation furthers the legislative goals of (1) symmetry between partners and sole proprietors, (2) conformity by taxpayers to the business entity chosen for federal tax purposes, and (3) simplicity in accounting. By referring to the net profits from business regulation, the partnership regulation clearly provides for symmetry between partners and sole proprietors: "a partnership shall determine its income or loss for purposes of this subsection in the same manner a sole proprietorship determines 'net profits from business'." Conformity is served because only entities that qualify and elect to be treated as partnerships for federal tax purposes, and are in business, are treated as partnerships under the Gross Income Tax Act. Partnerships, like sole proprietorships, should follow the business form chosen for federal tax purposes. Each partner's distributive share of partnership income is determined in accordance with the partnership agreement in the same manner as determined for federal income tax purposes. Accounting for the taxpayer is simplified for partners and partnerships in the same way as for sole proprietors. The proposed partnership regulation, like the proposed net profits from business regulation, reflects a revised interpretation of the requirements of income categories. All partnership income or loss, regardless of category or nature, is to be reported as partnership income within the category of distributive share of partnership income.

Under the proposed regulations, guaranteed payments are still treated as distributive share of partnership income, with one change. Guaranteed payments made to retired partners who are receiving such payments as a result of a period of service to the partnership, pursuant to a retirement agreement or pension plan, are treated as pension income rather than as partnership income.

A partner's unreimbursed expenses incurred in the conduct of the partnership's business may be deducted if the expenses meet the deductibility standard of an ordinary business expense as defined in the net profits from business regulation. This approach gives partners the same opportunity as sole proprietors to deduct expenses incurred in the conduct of the business.

Other subsections of the proposed partnership regulation are not substantively changed from the existing regulation. Allocation, reporting, and filing requirements for partnerships have been clarified but not changed. The treatment of contributions to Keogh plans has also been clarified. Examples have been simplified by separating out issues that arise frequently, rendering them more useful to both the Division and taxpayers.

Social Impact

These rules will have an impact on all sole proprietors, partnerships, and partners in the State. Proposed new rules N.J.A.C. 18:35-1.1 and 1.3 ensure that sole proprietors and partners are treated similarly under the Gross Income Tax. Such taxpayers must meet the same standards for reporting income and deducting costs and expenses. Moreover, symmetry will exist between these entities and S corporations and estates and trusts.

Conformity with federal accounting and substantive principles, where applicable, in determining net business income, will benefit taxpayers by the use of clearly delineated standards that are similar for both Federal and State taxes. Taxpayers will also have the clarity of federal rules governing the choice of business organization. Such conformity benefits the Division as well, since it need not investigate the reasonableness of the form of business reporting undertaken. The Division will benefit from clear and consistent methods of reporting income by taxpayers.

The proposed rules simplify the accounting requirements for businesses by adopting a new approach to accounting for income and losses for the Gross Income Tax. Businesses will be able to net business income against business losses, so long as both arise within the conduct of the business. This treatment will benefit taxpayers, through simplified reporting, and the Division, which will no longer be required to investigate the purpose of the business enterprise and the character of the income earned.

The proposed rule for partnerships and partners will have a beneficial effect on partners whose firms have chosen to allocate the economic responsibility for certain expenses to the individual partners rather than to the partnership as a whole. The change will benefit those partners who may need to spend more money than others in order to meet their obligations to attract clients and generate business for the partnership.

Economic Impact

The proposed new rules may reduce state revenue, because the liberalization of accounting requirements will permit more losses to be taken by sole proprietorships and partners. In addition, retired taxpayers may take advantage of the pension exclusion, thereby reducing their gross income tax liability. Conversely, these measures will result in reduced tax liability for partners and sole proprietors who can offset losses not previously usable. Retired partners will benefit because they will be able to take advantage of the pension exclusion for guaranteed payments that are characterized as pension income.

Individual partners who incur deductible business expenses for the partnership will be able to reduce their distributive share of partnership income by deducting previously nondeductible unreimbursed expenses.

By requiring conformity with the decision of business entity for federal income tax purposes, the proposed rules should promote more accurate income reporting. Administration of the Gross Income Tax Act should be less time-consuming for the Division because it can rely on the taxpayer's characterization of business entity.

Federal Standards Statement

An Executive Order No. 27 Analysis is not required because the rulemaking authority is granted by N.J.S.A. 54A:9-17(a) and the State Tax Uniform Procedure Law, 54:50-1, and is not subject to any Federal requirements or standards. Some of the proposed changes will ring the New Jersey reporting requirements closer the federal requirements.

Jobs Impact Statement

The Division does not anticipate that any jobs will be generated or lost as a result of the adoption of the proposed new rules.

Agriculture Industry Impact Statement

The proposed rules will affect farms that are organized as sole proprietorships and partnerships. Farms will report their income for state income tax purposes in the same business form that they use for federal income tax purposes. Farm businesses will benefit from the simplified reporting requirements provided in the rule.

Regulatory Flexibility Analysis

The proposed rules address the reporting requirements of all sole proprietorships, partnerships, and partners that are subject to the New Jersey gross income tax. The proposed rules will not adversely affect small businesses. On the contrary, the reporting, record keeping and other compliance requirements on small businesses have been simplified by the requirement that they conform their state business reporting to their federal reporting requirements. The proposed rules are designed to minimize the economic impact of reporting and record keeping requirements on small businesses.

Full text of the proposed repeal may be found in the New Jersey Administrative Code at N.J.A.C. 18:35-1.1 and 18:35-1.3.

Full text of the proposed new rules follows:

18:35-1.1 Net profits from business

(a) Each taxpayer is subject to gross income tax on the taxpayer's "net profits from business" within the meaning of N.J.S.A 54A:5-1b, which shall be determined as provided in this subchapter.

(b) For purposes of the Gross Income Tax Act, a sole proprietorship, which shall include self-employed individuals and independent contractors, is a form of business in which one taxpayer owns all the assets of a business and which is not a partnership or corporation. Sole proprietors shall report their income or loss as net profits from business.

(c) A taxpayer's net profits from business shall be determined by taking into account all income of the taxpayer derived from the conduct of a business, profession or any other activity intended to produce income, provided such activity qualifies for and reports as a trade or business for federal income tax purposes. All income attributable to the taxpayer's conduct of a trade or business, reduced by costs and expenses as provided in subsection (d) below, shall be taken into account in determining the taxpayer's net profits from business. All other income of the taxpayer subject to gross income tax that is not attributable to the conduct of a trade or business shall be included in one or more of the other categories of gross income specified in N.J.S.A. 54A:5-1 according to its character and shall not be includable in the category of income "net profits from business." The determination of whether income is derived from the conduct of a trade, business or profession shall be based upon an examination of facts and circumstances of the taxpayer's activities.

1. Income derived as remuneration for services rendered in the sole proprietorship's conduct of a trade or business shall be taken into account in determining a self-employed taxpayer's net profits from business. Income derived by a taxpayer in the taxpayer's capacity as an employee, as defined in N.J.A.C. 18:35-7.1, shall not be taken into account in determining the taxpayer's net profits from business, but rather shall be taxed under N.J.S.A. 54A:5-1a (salaries, wages, etc.).

2. Interest and dividend income derived by a taxpayer in the conduct of a trade or business shall be taken into account in determining a taxpayer's net profits from business. The taxpayer shall annex to the taxpayer's return a statement demonstrating that the interest or dividends were realized in the conduct of the trade or business. Interest and dividends from investment activities or other income-producing activities which do not constitute the conduct of a trade or business shall be separately stated on the taxpayer's return and taxed either as interest described in N.J.S.A. 54A:5-1e or dividends described in N.J.S.A. 54A:5-1f.

3. Rental income derived by a taxpayer in the conduct of a trade or business shall be taken into account in determining a taxpayer's net profits from business. Rental income of a taxpayer which is not received in the conduct of a trade or business shall be taken into account in determining the taxpayer's net gains or net income from rents, royalties, patents and copyrights described in N.J.S.A. 54A:5-1d.

4. Royalty, patent, or copyright income derived by a taxpayer in the conduct of a trade or business that licenses intangible property shall be taken into account in determining the taxpayer's net profits from business. Income derived from royalties, patents or copyrights of a taxpayer which is not derived from a trade or business shall be taken into account in determining the taxpayer's net gains or net income from or in the form of rents, royalties, patents and copyrights described in N.J.S.A. 54A:5-1d.

5. Gains from the sale, exchange or other disposition of trade or business property shall be taken into account in determining a taxpayer's net profits from business. The taxpayer shall annex to the taxpayer's return a statement which demonstrates that gains and losses from the sale, exchange, or other disposition of property were realized in the conduct of a trade or business. The sale, exchange or other disposition of property which is not directly related to or employed in the conduct of a trade or business must be reported as described in N.J.S.A. 54A:5-1c, net gains or income from the disposition of property. Gain or loss from the sale or liquidation of a business must be reported as described in N.J.S.A. 54A:5-1c, net gains or income from the disposition of property.

6. A taxpayer's distributive share of income or loss from a partnership, S corporation, or estate or trust shall not be taken into account in determining a taxpayer's net profits from business, regardless of the character of the income or the nature of the activities of the partnership, S corporation or estate or trust. Reporting of such income or loss shall be as follows:

i. Income or loss from a partnership shall be taken into account determining the taxpayer's distributive share of partnership income described in N.J.S.A. 54A:5-1k. For rules governing the taxation of income derived by a taxpayer from a partnership, see N.J.A.C. 18:35-1.3.

ii. Income or loss from an S corporation shall be taken into account in determining the taxpayer's pro rata share of S corporation income described in N.J.S.A. 54A:5-1p.

iii. Income from an estate or trust shall be taken into account in determining the taxpayer's net gains or income from estates or trusts described in N.J.S.A. 54A:5-1h.

7. A taxpayer's net profits from business shall be determined in accordance with the method of accounting utilized for federal income tax purposes. A taxpayer's net profits from business shall be determined by including any income which is subject to tax under the Gross Income Tax Act but which is exempt from federal income taxation (for example, interest on non-New Jersey municipal obligations) and by excluding any income which is exempt from tax under the Gross Income Tax Act but which is subject to federal income taxation (for example, interest or gains attributable to obligations described in N.J.S.A. 54A:6-14).

(d) A taxpayer's net profits from business shall be determined by taking into account all ordinary costs and expenses incurred in the conduct of that business. No deduction shall be allowed for taxes based on income; any civil, civil administrative or criminal penalty or fine assessed and collected for a violation of a state or federal environmental law, or any other assessment described in N.J.S.A 54A:5-1b(2); or any treble damages paid pursuant to N.J.S.A. 58:10-23.11fa. No deduction shall be allowed for any cost or expense which is not incurred in the conduct of the trade or business. Only ordinary business costs and expenses are deductible.

1. An ordinary business cost or expense must be:

i. Incurred primarily and directly in the pursuit of the business's income;

ii. Incurred as a common and accepted practice in that field of business;

iii. Required for and appropriate to the intended business purpose; and

iv. Reasonable in amount in relation to the intended business purpose.

2. The determination whether a business expense is ordinary shall be based upon the facts and circumstances of the expense. A taxpayer has the burden to demonstrate to the satisfaction of the Director that the cost or expense is deductible.

3. Business costs or expenses, which relate to business income exempt from tax under the Gross Income Tax Act, or which are partly or wholly nondeductible for federal income tax purposes, may be deductible ordinary business costs or expenses under the Gross Income Tax Act. For example, meal and entertainment expenses which constitute ordinary expenses incurred

in the conduct of a trade or business are fully deductible in determining a taxpayer's net profits from business.

(e) The allocation of sole proprietorship income derived from sources either within or outside of New Jersey shall be as follows:

1. Where the business activity is carried on solely within New Jersey, all items of income, gain, expense or loss of the business are deemed to have been derived from sources within New Jersey.

2. Where the business activity is carried on solely outside of New Jersey, the taxpayer must complete either New Jersey Business Allocation Schedule (Form NJ-1040-NR-A) or a schedule reflecting an approved allocation method under (e) 4 below. Failure to provide such schedule may result in allocation of all sole proprietorship income to New Jersey.

3. Where the business activity is carried on both within and outside of New Jersey, the portion of the business's income, gains, expenses or losses attributable to sources within New Jersey shall, except as provided in subsection 4 below, be determined by use of the New Jersey Business Allocation Schedule (Form NJ-1040-NR-A). Failure to provide such schedule may result in allocation of all sole proprietorship income to New Jersey.

4. Where the business activity is carried on (1) solely outside of New Jersey or (2) both within and outside of New Jersey, and the taxpayer believes that the determination of business income, gains, expenses or losses attributable to sources within and outside of New Jersey by use of the New Jersey Business Allocation Schedule does not provide an equitable allocation of such items, and the books and records of the business will disclose to the Director's satisfaction a more appropriate method of allocation of such items, the taxpayer may request from the Director an exception from the use of the New Jersey Business Allocation Schedule. Such request must be made in writing and set forth the basis of the request and the substitute method of allocation requested to be used. Such request shall be mailed to the Chief of the Gross Income Tax Audit Branch, New Jersey Division of Taxation , P.O. Box 269, Trenton, NJ 08646. The substitute method of allocation may not be utilized prior to the written approval of such request by the Director. The business's exception request, once approved, may not be changed without prior written approval of the Director. All exception requests must be renewed every three years.

(f) A taxpayer who is engaged in more than one trade or business as a sole proprietor must determine net profit or loss for each sole proprietorship separately. Once profit or loss from each sole proprietorship has been determined, the taxpayer must net such profits and losses and report the result in the category, "net profits from business."

(g) Sole proprietor filing requirements are as follows:

1. Resident and nonresident sole proprietorships subject to the Gross Income Tax must attach the following for each sole proprietorship:

i. Federal Schedule C or F; and

ii. A schedule detailing changes made to each Schedule C or F in arriving at New Jersey taxable income.

2. Resident taxpayers must report all of their business income regardless of source. Tax is imposed on all income.

3. Nonresident taxpayers must report all business income, regardless of source. Tax is imposed only on New Jersey source income.

(h) The provisions of this regulation are illustrated by the following examples:

Example 1:

Taxpayer is the sole proprietor of a hardware store. During the year the taxpayer receives the following income:

Interest from a personal savings account	$	300	^
Interest from a business checking account		50	^^
Dividends from personal stock		100	^
Gross receipts from hardware sales		250,000	^^

^ Personal income

^^ Business income

Disbursements made by the taxpayer's hardware business:

Ordinary expenses - deductible				**Nondeductible expenses**			
Cost of goods sold	$	80,000	*	Rutgers University	$	500	***
Rent		20,000	*				
Supplies		2,000	*				
Utilities		1,800	*				
Insurance		1,500	*				
Yellow pages (advertisement)		200	*				
Local Church (advertisement church bulletin)		800	**				

* These are ordinary business expenses in the operation of a hardware store and are deductible.

** This expenditure is deductible since the taxpayer is advertising his business in the church bulletin in hopes of attracting new customers.

*** This expenditure to Rutgers University, the taxpayer's alma mater, is not deductible. This expenditure is not incurred primarily and directly in the pursuit of business income, even though the taxpayer believes the university has an excellent business program which will provide possible future employees.

EXAMPLE 1 CONT:

Taxpayer will calculate his net profits from business as follows:

Income				
Business interest	$	50		
Gross receipts from hardware sales		250,000	$	250,050
Expenses				
Cost of goods sold	$	80,000		
Rent		20,000		
Supplies		2,000		
Utilities		1,800		
Insurance		1,500		
Advertisement				
Yellow pages		200		
Local church bulletin		800		(106,300)
Net profits from business:			$	143,750

Taxpayer will report his income on his New Jersey gross income tax return as follows:

Category		**Amount**
Interest	$	300
Dividends		100
Net profits from business		143,750
New Jersey gross income:	$	144,150

Example 2:

Taxpayers are a married couple living in New Jersey who file a joint gross income tax return. The wife, wh is an insurance agent, is an employee of a large insurance company. The husband is a self-employed trader of securities (stocks, bonds, futures). The couple has income from the following sources:

Non-business income			Business income		
Wages (from insurance co.)	$	90,000	Interest	$	4,000
Interest (from joint savings account)		10,000	Dividends		7,000
Dividends (non business investments held by taxpayers)		5,000	Gains on sale of securiti		400,000
Loss on sale of stock (non business investments held by taxpayers)		(70,000)	Losses on sale of secur		(100,000)
Gain on sale of undeveloped land		40,000			

Income earned by the husband as a "trader" in securities

Disbursements made by the husband as a trader in securities:

Ordinary expenses - deductible			Nondeductible expenses		
Investment interest expense	$	60,000 *	Keogh	$	7,500 **
Broker fees		5,000			
Home office expense		3,000			
Depreciation		2,000			
Meals/entertainment		500			
Journals/publications		200			

Disbursements made by the wife as an insurance agent:

Meals/entertainment	$	800 ***
Travel		600 ***

* Investment interest expense is deductible as an ordinary business expense if it is directly related to the production of business income by the business entity incurring the cost.

** The Keogh expenditure is not deductible as an ordinary business expense. Taxpayer is not an employee of the business.

*** The wife cannot deduct any expenses incurred in the performance of her duties as an insurance agent, in that she is an employee of the insurance company and not an independent contractor. See N.J.A.C. 18:35-1.21 and 18:35-1.23 for more detail.

Example 2 cont:

The husband will calculate his net profits from business as follows:

Income				
Interest	$	4,000		
Dividends		7,000		
Gains from sale of securities		400,000		
Losses from sale of securities		(100,000)	$	311,000
Ordinary expenses				
Investment interest expense	$	60,000		
Broker fees		5,000		
Home office expense		3,000		
Depreciation		2,000		
Meals/entertainment		500		
Journals/publications		200		(70,700)
Net profits from business:			$	240,300

Taxpayers will report their income on their New Jersey gross income tax return as follows:

Wages	$	90,000
Interest		10,000
Dividends		5,000
Net profits from business		240,300
Net income from disposition of property		0 #
New Jersey gross income:	$	345,300

\# Net income from disposition of property

Loss on sale of stock	$	(70,000)
Gain on sale of undeveloped land		40,000
Net income from disposition of property:	$	(30,000)

Taxpayers cannot apply their loss on disposition of property against their income attributable to other categories of New Jersey gross income.

Example 3:

Taxpayers are a married couple living in New Jersey who file a joint gross income tax return. The husband is employed by a large medical firm. The wife operates a rental real estate business at the Jersey shore which she personally manages and reports on her Schedule C of their federal return. The taxpayers also own a cabin in Killington, Vermont as an investment. They report the income from the cabin as rental income on their federal return. The property in Vermont is managed by a realty company that handles all aspects of renting and maintaining the property. The couple has income from the following sources:

Rental real estate business income

Rental receipts	$	200,000
Interest		500 ^

Non business income

Wages from medical fir	$	100,000
Interest from investments		6,000
Dividends from investmen		5,000
Rental receipts from VT pı		12,000

^ Interest earned on working capital

Disbursements made by the rental real estate business and by the taxpayers for the Vermont rental property:

Rental real estate business

Ordinary expenses - deductible

Depreciation	$	22,000
Utilities		15,000
Mortgage interest		13,000 *
Taxes		8,000
Repairs		5,000
Advertising		800

Vermont property

Ordinary expenses - deductible

Depreciati	$	4,000
Utilities		800
Mortgage int		6,000 *
Taxes		5,200
Commissions		1,000

* Interest paid to banks for the purchase of the rental properties.

Example 3 cont:

Taxpayers will calculate their net profits from business and rental income as follows:

Rental real estate business

Income

Rental receipts	$	200,000		
Interest		500	$	200,500

Ordinary expenses

Depreciation	$	22,000		
Utilities		15,000		
Mortgage interest		13,000		
Taxes		8,000		
Repairs		5,000		
Advertising		800		(63,800)
Net profits from business:			$	136,700

Vermont rental property

Income

Rental rec	$	12,000	$	12,000

Ordinary expenses

Depreciati	$	4,000		
Utilities		800		
Mortgage int		6,000		
Taxes		5,200		
Commissions		1,000	$	(17,000)
Net rental income:			$	(5,000)

Taxpayers will report their income on their New Jersey gross income tax return as follows:

Wages	$	100,000
Interest		6,000
Dividends		5,000
Net profits from business		136,700
Net gains or income from rents, royalties, patents & copyrights		0 #
New Jersey gross income:	$	247,700

Taxpayers cannot apply their rental loss of $5,000 against income attributable to other categories of New Jersey gross income.

18:35-1.3 Partnerships and partners

(a) The following words and terms, when used in this section, shall have the following meanings:

1. "Partnership" means and shall include a syndicate, group, pool, joint venture and any other unincorporated organization through or by means of which any business, financial operation or venture is carried on and which is not a corporation, trust or estate within the meaning of the New Jersey Gross Income Tax Act. Only entities that qualify for and elect to be treated as partnerships for federal tax purposes (e.g., Limited Liability Companies and Limited Liability Partnerships) and are in business shall be treated as partnerships under the Gross Income Tax Act.

2. "Partner" means any owner of a partnership interest and shall include any taxpayer subject to the Gross Income Tax who is a member of a partnership or other unincorporated entity taxed as a partnership. A partner cannot be an employee of the partnership for purposes of determining distributive share of partnership income.

(b) Partners, not partnerships, are subject to tax. Taxpayer partners shall be subject to Gross Income Tax on their distributive share of partnership income, whether or not distributed. Such income shall be reported as distributive share of partnership income, regardless of the character or category of the income derived by the partnership.

1. Partners who are resident taxpayers of New Jersey are subject to Gross Income Tax on their entire distributive shares of partnership income, regardless of the source of the income.

2. Partners who are nonresident taxpayers of New Jersey are subject to Gross Income Tax on their distributive shares of partnership income, but only to the extent such income was derived by the partnerships from sources within New Jersey. Refer to subsection (c) 3 below for rules governing sourcing or allocating income.

(c) The partnership's determination of a partner's distributive shares of partnership income or loss shall be as follows:

1. A partnership shall determine its income or loss for purposes of this subsection in the same manner a sole proprietorship determines "net profits from business" pursuant to N.J.A.C. 18:35-1.1 (c) and (d). Such income shall be taxed as distributive share of partnership income without regard to character or category of income earned by the partnership. Each partner's respective distributive share of the partnership's income shall be determined by the partnership agreement in the same manner as determined for federal income tax purposes.

2. Guaranteed payments shall be reported as distributive share of partnership income, except guaranteed payments received by a retired partner who is receiving such payments as a result of a period of service to the partnership pursuant to a retirement agreement

or pension plan. Such guaranteed payments will be treated as pension income to retired partners and should be reported by the partner as pension income, described in N.J.S.A. 54A:5-1j.

3. The allocation of partnership income derived from sources either within or outside of New Jersey shall be as follows:

i. Where a partnership's activity is carried on solely within New Jersey, all items of the income, gain, expense or loss of the partnership are deemed to have been derived from sources within New Jersey. No allocation schedule is required.

ii. Where a partnership's activity is carried on solely outside of New Jersey, the partnership must complete either New Jersey Business Allocation Schedule (Form NJ-1040-NR-A) or a schedule reflecting an approved allocation method under (c)3iv below. Failure to provide such schedule may result in allocation of all income to New Jersey. .

iii. Where a partnership's activity is carried on both within and outside of New Jersey, the portion of the partnership's income, gains, expenses or losses attributable to sources within New Jersey shall, except as provided in (c)3iv below, be determined by use of the New Jersey Business Allocation Schedule (Form NJ-1040-NR-A), as prepared by the partnership. Failure to provide such schedule may result in allocation of all income to New Jersey.

iv. Where a partnership's activity is carried on (1) solely outside of New Jersey or (2) both within and outside of New Jersey, and the partnership believes that the determination of partnership income, gains, expenses or losses attributable to sources within and outside of New Jersey by use of the New Jersey Business Allocation Schedule does not provide an equitable allocation of such items, and the books and records of the partnership will disclose to the Director's satisfaction a more appropriate method of allocation of such items, the partnership may request from the Director an exception from the use of the New Jersey Business Allocation Schedule. Such request must be made in writing and set forth the basis of the request and the substitute method of allocation requested to be used. Such request shall be mailed to the Chief of the Gross Income Tax Audit Branch, New Jersey Division of Taxation , P.O. Box 269, Trenton, NJ 08646. The substitute method of allocation may not be utilized prior to the written approval of such request by the Director. The partnership's exception request, once approved, may not be changed without prior written approval of the Director. All exception requests must be renewed every three years.

4. A tiered partnership shall take into account its distributive share of partnership income from any partnership of which it is a member. Once income has been allocated by a partnership, it may not be reallocated by the partners.

5. Partnership contributions to a Qualified Pension Plan under the Internal Revenue Code made on behalf of employees of the partnership and deductible as business expenses for federal income tax purposes also are deductible under N.J.A.C. 18:35-1.1 (d), consistent with (c)1 above, in determining the net income of the partnership.

(d) Partners who are taxpayers shall report their partnership income according to the following guidelines:

1. Partners who own more than one partnership interest must determine their distributive share for each partnership interest separately. Once distributive share from each partnership interest has been determined, taxpayers must net all distributive shares and report the total in the category, "distributive share of partnership income" under N.J.S.A. 54A:5-1k.

2. A partner may deduct unreimbursed expenses incurred in the conduct of the partnership's business if the expenses meet the deductibility standard of an ordinary business expense as described in N.J.A.C. 18:35-1.1 (d).

3. A partner's contributions to the partnership's qualified Keogh plan under the Internal Revenue Code are not deductible business expenses under the standard provided in N.J.A.C. 18:35-1.1 (d), consistent with (c)1 above. Such contributions are included in the participating partner's distributive share of partnership income reported for New Jersey gross income tax purposes. Previously taxed contributions to a Keogh Plan are not subject to tax when subsequently withdrawn by the partners.

4. Distributive share of partnership income or loss cannot be combined with other categories of income or loss. See N.J.A.C. 18:35-1.1 (c)6.

5. If the partner and the partnership have different taxable years, the partner reports his or her distributive share of partnership income for the partnership's taxable year that ended within the partner's taxable year.

6. A partner who is a resident taxpayer for part of any taxable year and a nonresident taxpayer for part of the same taxable year is required to report his or her distributive share of partnership income as follows:

i. The part-year resident return shall include the portion of the partner's distributive share of the partnership income determined by multiplying the partner's entire distributive share of partnership income as determined under (c) above by the percentage which the number of days of the partnership's fiscal year that the partner was a New Jersey resident bears to 365.

ii. The part-year nonresident return shall include the portion of the partner's distributive share of partnership income as follows:

(1) If the distributive share of partnership income was derived entirely from New Jersey sources, the portion of that distributive share of partnership income determined by multiplying the partner's entire distributive share of partnership income by the percentage which the number of days of the partnership's fiscal year that the partner was not a New Jersey resident bears to 365; or

(2) If the distributive share of partnership income was derived partly within New Jersey and partly outside New Jersey, the portion of such distributive share determined by multiplying the partner's entire distributive share of partnership income derived by the partnership from sources within New Jersey (determined as provided in (c)3ii or (c)3iii above), by the percentage which the number of days of the partnership's fiscal year that the percentage was not a New Jersey resident bears to 365.

iii. A partner who is a resident taxpayer for part of the tax year and a nonresident taxpayer for the remainder of the tax year must attach a schedule to the partner's part year NJ-1040 and the part year NJ-1040-NR showing the calculations used to determine the amounts reported on each return with respect to income or loss of a partnership.

(e) Partnership filing requirements are as follows:

1. Partnerships having a New Jersey resident partner or having any income or loss derived from New Jersey sources must file the following with the Division :

i. Form NJ 1065 including the partner directory;

ii. Schedule NJK-1 for every resident partner, a copy of which must be provided to the partner;

iii. Schedule NJK-1 for every nonresident partner, but only if the partnership had income or loss from New Jersey sources, a copy of which must be provided to the partner;

iv. Pages 1 through 4 of Federal Form 1065 and any federal extension request forms filed; and

v. Schedule NJ-NR-A, if required under subsection (c) 3 above.

2. Information filings must be made on or before the date of expiration of the permitted filing period for the partnership's Federal Form 1065, including any extensions of such period allowed for Federal income tax purposes.

3. Partnerships with partners subject to the Gross Income Tax shall make available and submit the following items at the Division's request:

i. Schedule NJK-1 for nonresident partners;

ii. A complete Federal Form 1065 including all schedules and supporting attachments; and

iii. Any other documentation or information the Division deems necessary.

(f) Partner filing requirements are as follows:

1. Resident and nonresident partners subject to the Gross Income Tax shall attach the following for each partnership:

i. The partner's New Jersey Schedule NJK-1 if received; or

ii. If no Schedule NJK-1 was received, Federal Schedule K-1 along with a schedule showing the calculation of New Jersey distributive share of partnership income.

2. Resident partners shall include with their New Jersey resident tax return a copy of the items specified in subsection 1 above, for each partnership in which the taxpayer is a partner, regardless of the source of the partnership's income or loss.

3. Nonresident partners in a partnership having income or loss from New Jersey sources shall, for each partnership, include a copy of the items specified in subsection 1 above with the partner's New Jersey nonresident tax return.

(f) The provisions of this regulation are illustrated by the following examples:

Example 1:

A partnership reported the following income on its Federal Schedule K (Form 1065):

Ordinary income	$	197,000
Interest income		1,000
1231 gain		2,000

The partnership in completing its NJ-1065 will determine partnership income as follows:

Ordinary income	$	197,000
Interest income		1,000
1231 gain		2,000
Partnership income:	$	200,000

The partnership has two full year resident partners who are not members of any other partnerships. Partner A has a 60% interest and partner B has a 40% interest. They will report their distributive shares of partnership income on their NJ-1040s as follows:

	Partner A (60%)	Partner B (40%)
Distributive share of partnership income:	$ 120,000	$ 80,000

Example 2:

A partnership reported the following income on its Federal Schedule K (Form 1065):

Ordinary income	$	75,000
1231 gain		6,000

The partnership also incurred the following expenses as reported for federal income tax purposes:

Section 179 expense	$	15,000
Meal & entertainment expenses (50% disallowed for federal)		3,000

The partnership in completing its NJ-1065 will determine partnership income as follows:

Income				
Ordinary income:	$	75,000		
1231 gain		6,000	$	81,000
Expenses				
Section 179	$	(15,000)		
Meal & entertainment		(3,000)		(18,000)
Partnership income:			$	63,000

The partnership has two full year resident partners who are not members of any other partnerships. Partner A has a 2/3 interest and partner B has a 1/3 interest. Partner A also has the following unreimbursed business expenses: automobile $800 and telephone $200. These ordinary business expenses were incurred in the conduct of the partnership's business and are deductible. The partners will report their distributive shares of partnership income on their NJ-1040s as follows:

		Partner A (2/3)		Partner B (1/3)
Distributive share of partnership income:	$	42,000	$	21,000
Unreimbursed business expenses				

Auto	(800)	
Telephone	(200)	
Distributive share of partnership income:	$ 41,000	$ 21,000

Example 3:

A partnership reported the following income on its Federal Schedule K (Form 1065):

Ordinary income	$	200,000	
Interest income		1,000	
Guaranteed payments		30,000	*

* Partner A received guaranteed payments of $20,000 for special services rendered.
Partner B received no guaranteed payments.
Partner C is retired and received guaranteed payments of $10,000 pursuant to the partnership's pension plan.

The partnership in completing its NJ-1065 will determine partnership income as follows:

Ordinary income	$	200,000	
Interest income		1,000	
Guaranteed payments		20,000	**
Partnership income:	$	221,000	

Guaranteed payments classified as pension income:	$	10,000

** Guaranteed payments are allocated to partners according to the partnership agreement.

Partners A and B are full year residents who each have a 50% interest in the profit and loss of the partnership. Partners A & B will each report 50% of the partnership income (excluding guaranteed payments) on their NJ-1040s as follows:

	Partner A (50%)	Partner B (50%)	Retired Partner C (00%)
Distributive share of partnership income: (excluding guaranteed payments)	100,500	$ 100,500	$ 0
Guaranteed payments:	20,000		
Distributive share of partnership income:	$ 120,500	$ 100,500	$ 0

Retired partner C who is a full year resident has no distributive share of partnership income to report on his NJ-1040; however, he must report pension income in the amount of $10,000.

Example 4:

Partner X elects to contribute $3,000 to her account in the qualified Keogh plan established by the partnership. Partner Y elects not to make a contribution to the plan. The partnership must include the $3,000 contribution made by partner X in her distributive share of partnership income in the taxable year the contribution was made. Partner X may not deduct her $3,000 contribution as an ordinary business expense. When subsequently withdrawn, partner X's previously taxed contribution will not be subject to tax.

Partners X & Y each elect to make a contribution of $5,000 to the partnership's 401(k) plan. They may deduct their contributions to the extent allowed under the Internal Revenue Code in determining their distributive share of partnership income.

The partnership reported the following income on its Federal Schedule K (Form 1065):

Ordinary income	$	98,000 *
Interest income		2,000

* The ordinary income is net of a $15,000 contribution made by the partnership to a Qualified Pension Plan on behalf of its employees.

The partnership in completing its NJ-1065 will determine partnership income as follows:

Ordinary income	$	98,000 **
Interest income		2,000
Partnership income:	$	100,000

** The $15,000 partnership contribution made to a Qualified Pension Plan on behalf of its employees is deductible as an ordinary business expense.

The partnership has two full year resident partners who are not members of any other partnerships. They each have an equal interest in the sharing of profit or loss. They will report their distributive shares of partnership income on their NJ-1040s as follows:

		Partner A (50%)		Partner B (50%)
Distributive share of partnership income:	$	50,000	$	50,000
401(K) contribution		(5,000)		(5,000)
Distributive share of partnership income:	$	45,000	$	45,000

401(K) contributions made by the partners are deductible. Keogh plan contributions made by the partners are not deductible.

Example 5:

A group of four friends form an investment club, structured as a partnership. Their partnership, in which they agree to share profit and loss equally, is in business. The partnership reported the following income on its Federal Schedule K (Form 1065):

Interest	$	300
Dividends		600
Short term capital loss		(400)
Long term capital gains		500

The partnership incurred the following expenses:

Brokerage fees	$	400
Accounting fees		500
Software		300
Rent		1,200

The partnership in completing its NJ-1065.will determine partnership income as follows:

Income

Interest	$	300		
Dividends		600		
Short term capital loss		(400)		
Long term capital gains		500	$	1,000

Expenses

Brokerage fees	$	(400)		
Accounting fees		(500)		
Software		(300)		
Rent		(1,200)		(2,400)
Partnership income:			$	(1,400)

Each full year resident partner will have a $350 distributive share of partnership loss to net against any distributive share of partnership income they may have from another partnership. Their resulting distributive share of partnership income will be reported on their individual NJ-1040s.

Example 6a:

A partnership that is in the business of manufacturing consumer products reported the following on its Federal Schedule K (Form 1065):

Ordinary income	$	200,000
Investment interest expense		(10,000)
179 expense		(8,000)

The investment interest expense resulted from a loan to finance improvement of machinery and equipment used in the business and meets the ordinary business expense standard.

The partnership in completing its NJ-1065 will determine partnership income as follows:

Ordinary income	$	200,000
Investment interest expense		(10,000)
179 expense		(8,000)
Partnership income:	$	182,000

The partnership has two full year resident partners. Partner A and partner B have equal shares. The partners will report their distributive share of partnership income on their NJ-1040s as follows:

	Partner A (50%)	Partner B (50%)
Distributive share of partnership income:	91,000	91,000

Example 6b:

A law firm partnership earned $600,000 of ordinary income during the calendar year. Partner A is financing 50% of his capital contribution to the partnership with a loan from the partnership. The interest on this loan is $4,000. Partner B's capital contribution came entirely from his own funds. The partnership in completing its NJ-1065 will determine partnership income as follows:

Ordinary income	$	600,000
Interest income		4,000
Partnership income:	$	604,000

Partners A and B share equally in profit and loss of the partnership. Partners A and B each will report $302,000 as distributive share of partnership income on their NJ-1040s. Partner A cannot deduct the $4,000 interest expense since the interest resulted from a loan used to buy equity in the partnership. Partner A is in the business of practicing law and investing in the partnership is his personal expense.

Example 6c:

A rental real estate partnership reported the following on its Federal Schedule K (Form 1065):

Rental income	$	21,000
Interest income		3,000
Investment interest expense		(20,000)

The investment interest expense of $20,000 resulted from the partnership financing a $300,000 distribution to the partners with a bank loan that required the partnership to pledge one of its buildings as collateral.

The partnership in completing its NJ-1065 will determine partnership income as follows:

Rental income	$	21,000
Interest income		3,000
Investment interest expense		0
Partnership income:	$	24,000

The investment interest expense cannot be deducted for New Jersey Gross Income Tax purposes since the transaction does not meet the ordinary business expense standard. Investment interest expense that flows out of the partnership to a partner may never be deducted by the individual partner as an ordinary business expense for New Jersey Gross Income Tax purposes.

The partnership has two full year resident partners. Partner A has a 2/3 interest and partner B has a 1/3 interest. The partners will report their distributive shares of partnership income on their NJ-1040s as follows:

	Partner A (2/3)	Partner B (1/3)
Distributive share of partnership income:	16,000	8,000

Example 7:

An individual taxpayer was a partner in three partnerships. Her distributive share of partnership income or loss from each of the partnerships was as follows:

Partnership K:	$	20,000
Partnership L:		(8,000)
Partnership M:		4,000
Total:	$	16,000

The taxpayer must net all her distributive shares of partnership income and report the total in the category distributive share of partnership income.

In addition to being a partner in these partnerships, the taxpayer was also a shareholder in an S corporation and a proprietor of a small business. Her other business activities resulted in the following:

Pro rata share of S corporation income	$	3,000
Net profits from business		(2,000)

The taxpayer cannot combine her net pro rata share of S corporation income of $3,000 with her distributive share of partnership income of $16,000 or her loss from her sole proprietorship of $2,000. Each category of income must be reported separately.

The taxpayer will report the following income on her NJ-1040:

Distributive share of partnership income	$	16,000
Net pro rata share of S corporation income		3,000
Net profits from business		0

The taxpayer must report a zero in the category net profits from business on her NJ-1040. Under the Gross Income Tax Act, a taxpayer may not offset losses in one category of income against income or gain in another category.

Example 8:

Partnership DEF is a partner in Partnership XYZ. As a partner, Partnership DEF received a schedule NJK-1 from Partnership XYZ that reported the following income:

	Total Partnership Income	NJ Sourced Partnership Income
Distributive share of partnership income:	$ 12,000	$ 6,000

In addition to its income from XYZ, Partnership DEF generated the following income during the calendar year:

Ordinary income	$ 46,000
Interest income	4,000

Partnership DEF completed the New Jersey Business Allocation Schedule (Form NJ-NR-A) and determined its percentage of partnership income allocated to New Jersey to be 10%. In determining its income allocation percentage, Partnership DEF includes neither the distributive share of partnership income nor the allocation factors of Partnership XYZ.

Partnership DEF will report its distributive share of partnership income as follows:

	Total Partnership Income	NJ Sourced Partnership Income
Ordinary income	$ 46,000	
Interest income	4,000	
Distributive share of partnership income:	$ 50,000	
Business Allocation Percentage = 10%		$ 5,000
Distributive share of XYZ partnership income (Per schedule NJK-1 from Partnership XYZ)	12,000	6,000
Distributive share of partnership income:	$ 62,000	$ 11,000

Partnership DEF cannot reallocate the income it received from Partnership XYZ.

Example 8 cont;

Partnership DEF has two partners who share equally in profits and losses. Partner L is a full year resident of New Jersey and partner M is a full year resident of Pennsylvania. Partnership DEF will report the following distributive share of partnership income on each of its partner's schedules NJK-1:

	Total Partnership Income	NJ Sourced Partnership Income
Distributive share of partnership income:	$ 31,000	$ 5,500

The partners will report their distributive share of partnership income on their individual returns as follows:

	Partner L (50%)	Partner M (50%)
NJ-1040	$ 31,000	
NJ-1040NR		5,500

Partner L, as a resident is subject to tax on her entire distributive share of partnership income, regardless of where it is sourced. Partner M, as a nonresident, is only subject to tax on his distributive share of partnership income that is sourced to New Jersey.

Example 9a:

A partner's taxable year ends on December 31, 1998, while the partnership's fiscal year ends on June 30, 1998. The partner is to report the partner's distributive share of partnership income from the partnership's taxable year ended June 30, 1998 on the partner's 1998 NJ-1040.

Example 9b:

A partner's taxable year ends on December 31, 1998, while the partnership's fiscal year ended on August 31, 1998. The partnership changed to a calendar year partnership in 1998. In addition to the partnership filing a fiscal year return covering the period from September 1, 1997 to August 31, 1998, the partnership must also file a short year return covering the period from September 1, 1998 to December 31, 1998.

The partnership reported the following distributive share of partnership income on the partner's schedules NJK-1:

NJK-1 (09/01/97 -- 08/31/98)	$	100,000
NJK-1 (09/01/98 -- 12/31/98)		30,000

The partner, who is not a member of any other partnership and who is a full year resident of New Jersey, is to report $130,000 as distributive share of partnership income on his 1998 NJ-1040. The partner has to report the total from both NJK-1s on his 1998 NJ-1040 since both taxable years of the partnership ended within the partner's taxable year.

Example 10:

Partnership ABC carried on business both within and outside of New Jersey. By completing the New Jersey Business Allocation Schedule (Form NJ-1040-NR-A), Partnership ABC determined that 60% of its partnership income is sourced to New Jersey.

Partnership ABC reported the following income on its Federal Schedule K (Form 1065):

Ordinary income	$	63,000
Dividend income		1,000
Net long-term capital loss		(4,000)

The partnership in completing its NJ-1065 will determine partnership income as follows:

Ordinary income	$	63,000
Dividend income		1,000
Net long-term capital loss		(4,000)
Partnership income:	$	60,000

Partnership ABC has partnership income from all sources of $60,000 and partnership income from New Jersey sources of $36,000 ($60,000 x 60%).

Partnership ABC has three partners who share equally in profits and losses. They are not members of any other partnerships. Partners A and B are each full year resident partners and partner C is a full year resident of New York. Partnership ABC will report the following distributive shares of partnership income on its partner's schedules NJK-1:

		Total Partnership Income		NJ Sourced Partnership Income
Distributive share of partnership income:	$	20,000	$	12,000

The partners will report their distributive share of partnership income on their individual returns as follows:

		Partner A (1/3)		Partner B (1/3)		Partner C (1/3)
NJ-1040	$	20,000				
NJ-1040			$	20,000		
NJ-1040NR					$	12,000

Partners A and B, as residents, are subject to tax on their entire distributive shares of partnership income, regardless of where it is sourced. Partner C, as a nonresident, is only subject to tax on his distributive share of partnership income that is sourced to New Jersey.

Example 11a:

Partnership ABC is a calendar year partnership that reported a distributive share of partnership income to partner A of $12,000. Partnership ABC's income is all sourced to New Jersey.

Partner A was a resident of New Jersey through September 30, 1998 and became a nonresident of New Jersey on October 1, 1998.

Partner A is required to file a part-year New Jersey resident return for the period from January 1, 1998 through September 30, 1998 and a part-year New Jersey nonresident return for the remaining three months of the calendar year.

Partner A will report a distributive share of ABC's partnership income in the amount of $8,975 on her part-year New Jersey resident return.

$$\#\# \quad \times \quad \frac{273}{365} \quad = \quad \$8{,}975$$

Partner A will report a distributive share of ABC's partnership income in the amount of $3,025 on her part-year New Jersey nonresident return.

$$\#\# \quad \times \quad \frac{92}{365} \quad = \quad \$3{,}025$$

Partner A must attach a schedule to both her part-year NJ-1040 and part-year NJ-1040-NR showing the calculations used to determine the amounts reported on each return.

Example 11b:

Partnership ABC is a fiscal year partnership that has a year end of November 30, 1998. Partnership ABC reported a distributive share of partnership income to partner A of $12,000. Partnership ABC's income is all sourced to New Jersey.

Partner A was a resident of New Jersey through September 30, 1998 and became a nonresident of New Jersey on October 1, 1998.

Partner A is required to file a part-year New Jersey resident return for the period from January 1, 1998 through September 30, 1998 and a part-year New Jersey nonresident return for the remaining three months of the calendar year.

Partner A will report a distributive share of ABC's partnership income in the amount of $9,995 on her part-year New Jersey resident return. Partner A must multiply her entire distributive share of partnership income by the percentage which the number of days of the partnership's fiscal year that partner A was a New Jersey resident bears to 365. Partnership ABC's fiscal year began on December 1, 1997 and partner A was a resident of New Jersey from December 1, 1997 through September 30, 1998.

$$\#\# \quad \times \quad \frac{304}{365} \quad = \quad \$9{,}995$$

Partner A will report a distributive share of ABC's partnership income in the amount of $2,005 on her part-year New Jersey nonresident return. Partner A must multiply her entire distributive share of partnership income (all sourced to New Jersey) by the percentage which the number of days of the partnership's fiscal year that she was not a New Jersey resident bears to 365. Partner A was not a resident of New Jersey as of October 1, 1998 and Partnership's ABC fiscal year ended on November 30, 1998.

$$\#\# \quad \times \quad \frac{61}{365} \quad = \quad \$2{,}005$$

Partner A must attach a schedule to both her part-year NJ-1040 and part-year NJ-1040-NR showing the calculations used to determine the amounts reported on each return.

Example 11c:

Partnership ABC is a fiscal year partnership that has a year end of November 30, 1998. Partnership ABC reported a distributive share of partnership income to partner A of $12,000. Partnership ABC determined that 20% of its income is sourced to New Jersey.

Partner A was a resident of New Jersey through September 30, 1998 and became a nonresident on October 1, 1998.

Partner A is required to file a part-year New Jersey resident return for the period from January 1, 1998 through September 30, 1998 and a part-year New Jersey nonresident return for the remaining three months of the calendar year.

Partner A will report a distributive share of ABC's partnership income in the amount of $9,995 on her part-year New Jersey resident return. Partner A must multiply her entire distributive share of partnership income by the percentage which the number of days of the partnership's fiscal year that partner A was a New Jersey resident bears to 365. Partnership ABC's fiscal year began on December 1, 1997 and partner A was a resident of New Jersey from December 1, 1997 through September 30, 1998.

$$\#\# \quad \times \quad \frac{304}{365} \quad = \quad \$9{,}995$$

Partner A will report a distributive share of ABC's partnership income in the amount of $401 on her part-year New Jersey nonresident return. Partner A must multiply her distributive share of partnership income that is sourced to New Jersey by the percentage which the number of days of the partnership's fiscal year that she was not a New Jersey resident bears to 365. Partner A was not a resident of New Jersey as of October 1, 1998 and Partnership ABC's fiscal year ended on November 30, 1998.

$$\#\# \quad \times \quad 20\% \quad = \quad \$2{,}400$$

$$\#\# \quad \times \quad \frac{61}{365} \quad = \quad \$401$$

Partner A must attach a schedule to both her part-year NJ-1040 and part-year NJ-1040-NR showing the calculations used to determine the amounts reported on each return.

LAW OFFICES
WOLF, BLOCK, SCHORR AND SOLIS-COHEN LLP
TWELFTH FLOOR PACKARD BUILDING
111 SOUTH 15TH STREET
PHILADELPHIA, PA 19102-2678
(215) 977-2000
FACSIMILE: (215) 977-2334

JOSEPH C. BRIGHT
DIRECT DIAL: (215) 977-2022
FACSIMILE: (215) 977-2740
E-MAIL: JBRIGHT@WOLFBLOCK.COM

Original: 1882
Copies:
Tyrrell
Sandusky
Wyatte

December 9, 1997

Anita M. Doucette
Office of Chief Counsel
Department of Revenue
Department 281061
Harrisburg, PA 17128-1061

RE: Proposed Reg. §103.12

Dear Ms. Doucette:

We suggest that the proposed amendment to Section 103.12 of the Regulations be amended (indicated by underlining) as follows:

> (b) Net profits are different from other classes of personal income in that:
>
> (1) The profits are derived from the marketing of a product or service to customers on a commercial basis; from securities employed as working capital in the business operations; from the active conduct of a securities trade or business; from accounts and notes receivable from sales of products or services sold in the ordinary course of the business operations; or from assets which serve an operational function in the ordinary course of business operations.

The question whether income is earned in a trade or business has been the subject of two noteworthy cases. In Commissioner v. Groetzinger, 480 U.S.C. 23 (1987), the United States Supreme Court held that conducting a trade or business was not limited to selling goods and services in the marketplace but included conducting an active trade or business. In Smith v. Director, Division of Taxation, 108 N.J. 19, 527 A.2d 843 (1987), the New Jersey Supreme Court came to the same conclusion in the context of a statute virtually identical to Pennsylvania's. It will provide helpful guidance to taxpayers if the rule of these two cases --that

DSC:441843.1

income from the active conduct of a securities trade or business constitutes net profits— is made clear in the new regulation.

Very truly yours,

Joseph C. Bright
For WOLF, BLOCK, SCHORR and SOLIS-COHEN

JCB/cs

cc: James W. Bruce, Esquire

bc: Joel K. Greenberg, Esquire

DSC:441843.1

LAW OFFICES
WOLF, BLOCK, SCHORR AND SOLIS-COHEN LLP
TWELFTH FLOOR PACKARD BUILDING
S.E. CORNER 15TH AND CHESTNUT STREETS
PHILADELPHIA, PA 19102-2678
(215) 977-2000
FACSIMILE: (215) 977-2334 OR 977-2346

Date: September 23, 1998

Number of Pages (including this cover):

If you have problems receiving this transmission, please contact us at (215) 977-2757 or (215) 977-2764

To:	Charles A. Tyrrell, Jr.
Company:	Independent Regulatory Review Commission
Recipient's FAX #:	717-783-2664
Recipient's Phone #:	717-772-3455
Sender:	Joseph C. Bright, Esquire
Sender's Phone #:	215-977-2022
Special Message:	

✔ Original WILL NOT follow

Original WILL follow via:

Regular Mail
Overnight Delivery
Hand Delivery
Other:

SUS034-093422

LAW OFFICES
WOLF, BLOCK, SCHORR AND SOLIS-COHEN LLP
TWELFTH FLOOR PACKARD BUILDING
111 SOUTH 15TH STREET
PHILADELPHIA, PA 19102-2678
(215) 977-2000
FACSIMILE: (215) 977-2334

JOSEPH C. BRIGHT
DIRECT DIAL: (215) 977-2022
FACSIMILE: (215) 977-2740
E-MAIL: JBRIGHT@WOLFBLOCK.COM

September 23, 1998

FAX MEMORANDUM

TO: Charles A. Tyrrell, Jr.
Regulatory Analyst
Independent Regulatory Review Commission

FROM: Joseph C. Bright, Esquire JCBright

RE: ***Letter of December 9, 1997***

Attached is a copy of my letter of December 9, 1997 to the Office of Chief Counsel. Evidently the Department passed on a copy to IRRC, following which Ann Marie Bereschak called me to discuss it.

After you have had a chance to review the authorities, perhaps you could give me a call.

Thank you.

JCB:jt

DSC:527768.1