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Massachusetts proposed budget includes tax on pass-through entities' non-insurance income

On January 25, 2012, Governor Deval Patrick submitted his budget recommendations for Fiscal Year 2013 to the Massachusetts Legislature. "Outside Section 9" of the bill contains a number of tax provisions including a "market-based" approach for sourcing service receipts when determining the Massachusetts sales factor (along with a "throw-out" rule) and a delay of the implementation of the FAS 109 deduction for corporations from the 2013 tax year to the 2014 tax year. Of particular importance to insurance companies, the budget would impose the corporate excise on the "non-insurance" income of a partnership or disregarded entity where an insurance company owns at least 50% of the partnership or disregarded entity.

Taxing the non-insurance business of insurance companies

Massachusetts currently exempts insurance companies from the state's corporate excise tax (*i.e.,* an income based tax).

The proposed amendment would treat certain partnerships and disregarded entities as if they were corporations, subjecting the income of such entities to the corporate excise tax. Specifically, if an insurance company owns 50% or more of the capital or profits interest in a partnership or disregarded entity that is engaged in a "non-insurance" trade or business (not defined in the proposal), then the income from such non-insurance trade or business would be taxed to the partnership or disregarded entity as if it were a corporation.

- Partnerships and disregarded entities so treated as corporations would be required to file returns as if they were business corporations and, if applicable, would be included in a Massachusetts combined report.

- The term "partnership or disregarded entity" would include real estate investment trusts ("REITs"). To the extent that a REIT's income is subject to tax under the proposal, Massachusetts would not recognize a dividends paid deduction on the distribution of such income.

The proposed amendment would be effective for tax years beginning on or after January 1, 2013.

Proposal echoes prior attempts and current multistate initiative

A similar measure with respect to taxing "non-insurance" income from pass-through entities was previously proposed in Massachusetts (see H. 3756, filed by Governor Patrick in 2007), but failed to pass.

Additionally, the Multistate Tax Commission (MTC) is considering draft model legislation very similar to the current Massachusetts proposal. The MTC project seeks to impose state income tax on flow-through entities that are owned by entities that are not subject to the corporate income tax. This includes insurers, but also can include other entities such as utilities. The MTC proposal was recently sent back to the Income and Franchise Tax Uniformity Subcommittee for further development, and the task of revising the model has been delegated to a "Non-Income Taxpayer Drafting Group." The drafting group's teleconference meetings are open to the public. At this point, the MTC appears to be looking to rewrite the proposal so that it may be more acceptable to stakeholders, including insurers.

***For further information**, please feel free to contact Anthony DiGilio at (703) 918-4812 or contact your local insurance tax professional.*

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