MTC discontinues work on pass-through model statute

May 24, 2013

In brief

On May 9, 2013, the Multistate Tax Commission's Executive Committee terminated work on a model tax statute on partnership or pass-through entity income ultimately realized by an entity that is not subject to income tax. Insurance companies, real estate investment trusts, and general pass-through entities that may have been impacted by the model statute should be aware that activity on the statute has ceased. [*Partnership or Pass-Through Entity Income Ultimately Realized by an Entity that is not Subject to Income Tax Document Library*, Multistate Tax Commission]

In detail

Draft model statute

As drafted, the model statute would have required a partnership or disregarded entity owned 50% or more, directly or indirectly, by an entity 'not subject to income tax' in a state to be taxed on the net income that passes through to such an owner as if the disregarded entity were a corporation subject to the state's income tax.

Earlier versions of the model statute: (1) defined a 'partnership or disregarded entity' to include a real estate investment trust (REIT) and (2) disallowed a REIT's dividends paid deduction if the REIT were owned 50% or more by an entity not subject to state income tax. The current February 2013 version of the model statute no longer includes these provisions.

Strong opposition felt by the MTC

Work began on the model statute in 2008. Almost immediately, the Executive Committee faced opposition from several groups, including the National Conference of Insurance Legislators and a coalition of industry trade groups. Of particular concern were the consequences such legislation would have on insurance companies since they generally are subject to premiums taxes rather than corporate income taxes.

The Committee has ceased work on the draft model statute and will instead memorialize its work in a white paper.

The takeaway

The draft legislation caused concern for several reasons. Critics raised the issue that including REITs within the definition of pass-though entities was unnecessary given the Commission's Model Captive REIT statute. These concerns were apparently addressed by specifically excluding REITs from the definition of a pass-through entity in subsequent versions of the model statute.

The model statute provided no meaning around the term 'not subject to an income tax.' As a result, the statute had the potential to include tax-exempt organizations (e.g., a pension plan) within its scope.

While opposition to the model statute was focused on inequities imposed on insurance companies and REITs, adverse consequences could have impacted general pass-through entities as well, effectively taxing them as if they were corporations.

The Commission abandoning its efforts to continue work on the *Partnership or Pass-Through Entity Income Ultimately Realized by an Entity that is not Subject to Income Tax* model statute should come as a relief to insurance companies, REITs, and other owners of pass-through entities that would have been adversely affected by the model statute.

Let's talk

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