The Commonwealth of Massachusetts

Department of Revenue
Office of the Commissioner
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NAVJEET K. BAL
COMMISSIONER

February 12, 2008

Jan Goodwin
Secretary, New Mexico Taxation and Revenue Department
Chair, Multistate Tax Commission
P.O. Box 630
Santa Fe, NM 87504-0630

Joe Huddleston
Executive Director, Multistate Tax Commission
444 North Capitol St., NW,
Suite 425
Washington, DC 20001-1538

Dear Secretary Goodwin and Executive Directive Huddleston:

I would like to request that the Uniformity Committee of the Multistate Tax Commission consider undertaking a model state statute/regulation project. Michael Fatale, Chief of the Rulings and Regulations Bureau of the Massachusetts Department of Revenue, will present a more detailed proposal regarding this project at the MTC's March meeting.

Specifically, the Department will request in March that the MTC's Uniformity Committee consider a project to address the tax equity problems that arise when insurance companies, which under most state statutes are taxed only on their gross insurance premiums, own interests in partnerships and limited liability companies (LLCs) that generate income from non-insurance businesses. In this situation, income from the non-insurance businesses typically "flows through" to the insurance company owners for federal and state tax purposes, and thus may not be subject to any state income tax. The Department is concerned that the structure is being used for tax avoidance. We understand that the issue concerns other states as well, so that a model proposal by the MTC would serve to advance the important interest of state uniformity.

My request arises from events in Massachusetts beginning with a legislative proposal in 2007. Specifically, on February 29, 2007, Governor Patrick filed legislation, House No. 3756, An Act Improving the Fairness of the Tax Laws, which was, among other things, intended to close certain tax "loopholes" in Massachusetts. The bill included a proposal to impose tax on the non-insurance income of partnerships and LLCs to the extent owned and controlled by insurance companies.

On April 30, 2007, the Governor, acting together with the Speaker of the House and the Senate President, appointed a fifteen-member Study Commission on Corporate Taxation to consider the provisions included in the Tax Fairness bill, as well as other aspects of this state's

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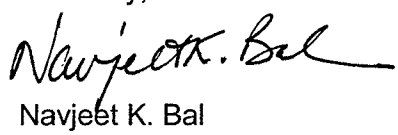
tax law. The Study Commission subsequently established several subcommittees to focus on specific provisions in the Tax Fairness bill and in the existing Massachusetts tax laws.

The proposal with respect to non-insurance income of flow-through entities owned by insurance companies was evaluated by a three-person subcommittee chaired by former Commissioner of Revenue Alan LeBovidge. This subcommittee issued a final report on November 12, 2007. One question considered by the subcommittee was whether this proposal, because of its relationship to insurance companies, would have "retaliatory tax" implications, and, if so, whether these implications would put in-state insurance companies at unfair competitive disadvantage vis-à-vis insurers that are based in other states. The members of the subcommittee had some concerns as to this retaliatory tax issue, and the proposal was revised to respond to those concerns. The revised proposal would subject the partnership or LLC to income tax to the extent that the income would otherwise flow through to an owner such as an insurance company that is not subject to an income tax. On that basis, the subcommittee recommended adoption of the Governor's proposal by a 2-1 vote. The dissenting member of the subcommittee expressed concern that retaliatory taxes would remain an issue.[1]

The recommendations of this subcommittee were then reported back to the full Study Commission. The Commission, after further deliberations with respect to the various issues before it, voted to recommend that the non-insurance income proposal be included in the category of items for further study. Several Commission members commented that the questions as to a potential threat of retaliatory taxation, in particular, warranted more comprehensive review.

It is my view that the goals of further study of this proposal, including an examination of the retaliatory tax issue, would be advanced most effectively if the MTC's Uniformity Committee were to research the matter and, if found reasonable to do so, pursue a project to draft a model statute/regulation. Such project could consider both the underlying facts and applicable legal frameworks that may give rise to tax avoidance in this area and the concerns expressed as to risks of retaliatory taxation. I believe these issues lend themselves to multistate consideration, so that the views of the various states as well as taxpayers can all be taken into account in one set of proceedings. Thus, it seems appropriate for the MTC to address this issue at this time, in the interest of promoting uniform state rules and ensuring consistent taxation of business income.

Sincerely,



Navjeet K. Bal
Commissioner of Revenue

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[1] The subcommittee's report, including the proposal and related discussion with respect to non-insurance income of flow-through entities controlled by insurance companies, is set forth at Appendix N of the Study Commission's Final Report, which can be accessed at: http://www.mass.gov/Ador/docs/dor/Publ/PDFS/Study%20Commission%20on%20Corporate%20Taxation%20-%20Final%20Report.pdf.