



**MULTISTATE TAX COMMISSION**

**Income and Franchise Tax Uniformity Subcommittee Meeting**

**Via Teleconference**

**Tuesday, February 5, 2013**

**3:30 P.M. EST**

**Minutes of the Meeting**

**I. Welcome and Introductions**

Robynn Wilson, Chair of the Income and Franchise Tax Uniformity Subcommittee, opened the meeting. The following persons were in attendance:

<b>Name of Attendee</b>	<b>Affiliation</b>	<b>Name of Attendee</b>	<b>Affiliation</b>
Shirley Sicilian, Bruce Fort, Roxanne Bland, Elliott Dubin, Sheldon Laskin, Lila Disque	MTC	Matt Pearle	North Dakota Office of State Tax Commissioner
Robynn Wilson	Alaska Department of Revenue (Chair)	Michael Fatale	Massachusetts Department of Revenue
Richard Cram	Kansas Department of Revenue	Wood Miller	Missouri Department of Revenue
Stewart Binke	Michigan Department of Treasury	Phil Horwitz	Colorado Department of Revenue
Don Jones, Jeff Henderson	Oregon Department of Revenue	Diann Smith	McDermott Will & Emery
Dan DeJong	Tax Executives Institute	Todd Lard	Council on State Taxation
Amy Hamilton	State Tax Notes	Terry Frederick	Sprint

**II. Public Comment Period**

There were no comments.

**III. Continuing Discussion of Possible New Project Regarding State Use of "Section 482" Authority**

At Ms. Wilson's request, Bruce Fort, MTC counsel, gave an overview of the project. The uniformity subcommittee has been considering a potential Section 482 project since last summer. The committee previously voted to solicit public comment about the potential project. The staff sent a list of possible factors to consider to some members of the tax community which might guide their comments, such as whether they have previously had Section 482 dealings with the states, and whether the project would be helpful. Mr. Fort also posted online a Jan 12, 2013, memo to the chairperson outlining some considerations for the project.

About 14 states already have what amounts to a Section 482 statute, which provides that the commissioner can adjust income and expenses between related parties. The federal regulations related to the statute, 26 CFR 1.482.1-6, are explicitly based on arm's-length accounting. However, Mr. Fort believes the states are not bound by this federal regulation, and may use a different method to accurately reflect income. The purpose of the meeting is to solicit input from the business community and the states.

At this point, Ms. Wilson asked for public comment. Todd Lard (COST) stated that, generally, COST members believe the project is unnecessary. Mr. Lard feels the project would create complexity and confusion for taxpayers because it seems to permit some nonconformity with the federal system, and may allow a subjective interpretation of business transactions. In addition, Mr. Lard would prefer to reserve Section 482 for rare use as a final option. He does not believe this is a project that warrants going forward.

There was no further public comment, and Ms. Wilson opened the floor for committee discussion. In response to a question from Mr. Miller (MO), Mr. Fort explained that, per regulation, the federal Section 482 adjustments are explicitly based on arm's-length pricing. One purpose of this project is to suggest that the states are not limited by arm's-length accounting; they can also use the apportionment formula to prevent misstatements of income. This would not be an adjustment of income between states but an adjustment of income between entities. Mr. Fort clarified that the regulations under Section 482 are not directed solely at transfer pricing, and there are other methods to adjust income.

The other purpose for the proposed regulation would be to assist states that do not have a separate 482 authority in establishing their ability to make 482 adjustments by virtue of their adoption of the federal tax code to determine state taxable income. In [\*Gannett v. Comptroller \(Md. App. 1998\)\*](#), the court of appeals said the state did not have authority to use Section 482 adjustments because it is discretionary with the IRS, and there was no indication the legislature felt it was something the state could use. This project would serve a double purpose by allowing those states without separate authority to essentially reverse the *Gannett* decision. Mr. Fatale expressed concern about how well a model regulation would interact with different state standards.

Ms. Wilson asked whether there was any action the committee wished to take. Mr. Miller stated it should remain on the agenda for the next meeting in March. Richard Cram (KS) requested a representative sample of some of the state Section 482-style statutes. Mr. Fort agreed, and noted the statutes tend to be very similar since several states have based their combined filing statutes on the Section 482 language. Indiana and North Carolina use the "clearly reflect" language to allow "forced" combination, while Arizona uses 482's language as the basis for that state's mandatory combination laws.

Mr. Fort will provide copies of all the statutes available, and in response to Mr. Cram's request, notation of any on-point state court case, although there is very little reported litigation he is aware of. With that, the subcommittee moved to the next item on the agenda.

#### **IV. Continuing Discussion of Model Statute for Partnership or Pass-Through Entity Income Ultimately Realized by an Entity That Is Not Subject to Income Tax**

Sheldon Laskin, MTC counsel, provided an overview of the project. During the MTC executive committee meeting in December, Mr. Fatale suggested revisions to the proposal in order to address some of the concerns of the insurance trades. The committee directed him to prepare a revised draft and present it to the subcommittee for consideration.

Mr. Fatale explained this project was not designed nor is it directed exclusively at the insurance industry; it applies whenever an entity that is not subject to tax owns and controls a pass-through entity. Industry representatives requested an exception for investments in real estate and "other traditional insurance-related activities," but they did not supply proposed language. Mr. Fatale incorporated the exceptions in his proposed revision. He emphasized that either, both, or none of the provisions could be added.

The first provision allows for an exception where the entity not subject to tax owns and controls a pass-through entity, in which case the model would apply but with an exception for the income and other attributes that derive from a transaction between the pass-through entity and the insurance company where the entity is an integral part of the insurance business. A second exception is with respect to real estate. Income from the rental and disposition of real estate directly owned by the pass-through entity would not be subject to tax.

Ms. Wilson asked for public comments. There were none, so she opened the floor for committee discussion or questions. Phil Horwitz (CO) asked whether any thought was given to an UBTI approach rather than the two narrow exceptions. Mr. Fatale said this had been mentioned in earlier discussion but industry never submitted a proposal. Industry argues it would be subject to a retaliatory tax under the MTC proposal, and the UBTI approach would seem to increase the possibility of retaliatory tax being assessed. Mr. Fatale's language was an attempt to directly address industry concerns. In response to a question, he stated the proposal is directed at situations where the pass-through entity's undertaking is unrelated to insurance. But the two exceptions are situations that appear *not* to be unrelated to the insurance industry. More particularly, these are the types of activities that traditionally would have been conducted in the insurance company itself.

There were no further questions. Ms. Wilson asked whether there was any action the committee would choose to take at this time. Mr. Horwitz recommended the committee adopt the proposed language and incorporate it into the draft, as they seem like an appropriate response to some of the concerns raised and they improve the model. He would recommend moving the draft up to full uniformity to pass on to the executive committee. Ms. Wilson asked whether there was any discussion on the motion. There was none. Ms. Wilson called for the vote. There were three 'ayes' and zero 'nays'. Michigan abstained from the vote.

#### **V. Adjourn**

At this time, Ms. Wilson stated she would entertain a motion to adjourn. Mr. Horwitz moved to adjourn, and the motion passed. The meeting concluded at 4:23 PM EST.