



Report of the Hearing Officer Regarding Proposed Model Statute Regarding  
Partnership or Pass-Through Entity Income That is Ultimately Realized By an Entity  
That Is Not Subject to Income Tax  
May 2011

**I. Procedural Summary**

**A. Development of the Proposal**

The MTC Income and Franchise Tax Subcommittee initiated this project at its March 2008 meeting, in response to a letter from the Commissioner of the Massachusetts Department of Revenue to MTC Executive Director Joe Huddleston, dated February 12, 2008.<sup>1</sup> Commissioner Bal requested that the MTC consider undertaking a project to address tax inequities presented by a business structure that allows entities not subject to state income tax to conduct another business through a partnership or disregarded entity. Ordinarily, the income of a pass through entity would be taxed upon its receipt by an entity that is subject to state income tax. But if the recipient of the income is not subject to state income tax, no tax is imposed either on the pass through or on the non-taxable entity. This is not consistent with the purpose of pass through entities, which is not to create non-taxable income but to assure that taxable income is only taxed once and not at both levels. The subcommittee assigned the drafting of the proposal to a drafting group consisting of Michael Fatale of Massachusetts, Phil Horowitz of Colorado and Brenda Gilmer of Montana.<sup>2</sup> Throughout the history of the project, the drafting group regularly reported its suggestions to the subcommittee and revised its drafts in response to the instructions of the subcommittee, both at regularly scheduled subcommittee meetings and during public teleconferences.

On June 28, 2008 Wood Miller, then chair of the subcommittee, Shirley Sicilian, General Counsel of the MTC, Sheldon Laskin, MTC Counsel and the Hearing Officer for this proposal, and Dave Davenport of Massachusetts (participating by telephone) met with representatives of the Trades at MTC headquarters in Washington, DC. During that meeting, the Trades made an educational presentation entitled *Insurance Company Taxation* which covered the gross premium tax, retaliatory tax and the state income tax of insurance companies (including reciprocal credits where an insurance company is subject

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<sup>1</sup> A copy of Commissioner's Bal's letter is attached to the public hearing submission of the American Council of Life Insurers, American Insurance Association and the Property Casualty Insurers Association of America (hereinafter, "the Trades"), dated May 16, 2011. A copy of the Trades' submission is attached hereto as Exhibit B.

<sup>2</sup> Carl Joseph of California initially participated in the drafting group but was unable to continue due to the press of his other responsibilities.

to both gross premium tax and state income tax)<sup>3</sup>. State concerns regarding insurance companies, such as overstuffing of assets into reserves, were also discussed. The Trades were invited to make its presentation to the entire subcommittee at its meeting of July 28, 2008 and the Trades did so.

Also at the July 28, 2008 meeting, Gary Johnson of the Tax Policy Division of the Texas Comptroller of Public Accounts made an educational presentation to the subcommittee titled *State Taxation of Insurance Organizations, Insurance Premium Tax, Miscellaneous Fees, Assessments and Retaliatory Tax: State Tax Planning and Court Case Review*. The Trades actively participated in the subcommittee discussion that followed both presentations.<sup>4</sup>

At the July 2008 meeting, the subcommittee expressed concerns around a wide ranging group of issues regarding the taxation of insurance companies. Those issues included the use of captive insurance companies by non-insurers, issues unique to particular investments by insurance companies, overcapitalization of insurance companies and overstuffing of insurance company reserves. The drafting group was instructed to research all issues relating to the state taxation of insurance companies and to report its research back to the subcommittee.

The drafting group met periodically by teleconference for about a year, identifying potential issues for the subcommittee to consider and proposing tentative solutions for those issues. At its meeting of July 2009, the subcommittee directed the drafting group to recommend a prioritization of those issues and possible solutions. At its teleconference on October 7, 2009, the subcommittee directed the drafting group to prepare a proposed draft statute addressing the pass through issue, to be followed thereafter with continuing work on the overcapitalization issue. In November 2009, the drafting group presented a draft statute to the subcommittee. The subcommittee directed the drafting group to revise the draft. Two alternative drafts were presented to the subcommittee in July 2010, which issued additional drafting instructions to the drafting group. The subcommittee approved the draft statute at its meeting in October 19, 2010 and the full Uniformity Committee concurred. The Executive Committee approved a public hearing in this matter via teleconference on March 10, 2011.

## **B. Public Hearing**

Following 30 days notice to the public and interested parties, a public hearing was held on May 16, 2011.<sup>5</sup> Tracy Williams, Esquire, representing the Trades appeared at the public hearing and submitted written and verbal comments, as did Dara F. Bernstein, Senior Tax Counsel of the National Association of Real Estate Trusts (NAREIT). Kathleen Curtis, Esquire, offered verbal comments on behalf of General Growth

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<sup>3</sup> Such credits almost always result in an insurance company being subject only to gross premium tax.

<sup>4</sup> The Hearing Officer wishes to acknowledge the active participation of the Trades throughout the history of this project and to express his appreciation for that participation. In addition to its formal presentation at the July 2008 meeting, the Trades made an additional formal presentation at the July 2010 meeting.

<sup>5</sup> A copy of the Notice of Public Hearing and proposed model regulation is attached hereto as Exhibit A.

Properties. The following submitted written comments only: Selvi Stanislaus, Executive Officer of the California Franchise Tax Board and Michael Fatale, Chief, Rulings & Regulations Bureau of the Massachusetts Department of Revenue. Following the public hearing, the Hearing Officer left the record open for 10 days so that interested parties could submit additional comments. Navjeet Bal, Commissioner of Revenue of the Massachusetts Department of Revenue did so in a letter dated May 23, 2011. The Trades filed a supplemental statement on May 26, 2011, as did NAREIT. All written comments are attached hereto as Exhibits B through H:

Exhibit B: *Comments on MTC's Proposed Statute Regarding Partnership or Pass-Through Entity Income That is Ultimately Realized By an Entity That Is Not Subject to Income Tax* (May 16, 2011), submitted by the Trades.

Exhibit C: *Supplemental Comments on MTC's Proposed Statute Regarding Partnership or Pass-Through Entity Income That is Ultimately Realized By an Entity That Is Not Subject to Income Tax* (May 26, 2011), submitted by the Trades.

Exhibit D: *Comments on Multistate Tax Commission's Proposed Model Statute Regarding Partnership or Pass-Through Entity Income That is Not Subject to Income Tax* (May 12, 2011), submitted by NAREIT.

Exhibit E: *Supplemental Comments on Multistate Tax Commission's Proposed Model Statute Regarding Partnership or Pass-Through Entity Income That is Not Subject to Income Tax* (May 26, 2011), submitted by NAREIT.

Exhibit F: *Comments Re: Public Hearing Regarding Proposed Model Statute for Pass-Through Entities and Exemptions* (May 16, 2011), submitted by Michael Fatale.

Exhibit G: *Comments in Support of MTC's Proposed Statute Regarding Partnership or Pass-Through Entity Income That is Ultimately Realized by an Entity That is Not Subject to Income Tax* (May 23, 2011), submitted by Massachusetts Revenue Commissioner Navjeet K. Bal.

Exhibit H: *Comments Regarding Proposed Statute Regarding Partnership or Pass-Through Entity Income That is Ultimately Realized by an Entity That is Not Subject to Income Tax* (May 13, 2011), submitted by Selvi Stanislaus, Executive Officer, California Franchise Tax Board.

### **III. Summary of Substantive Provisions**

#### **A. Purpose of Proposed Model Statute**

The proposal is designed to address tax inequities presented by a business structure that allows entities not subject to state income tax to conduct another business through a partnership or disregarded entity. Ordinarily, the income of a pass through entity would be taxed upon its receipt by an entity that is subject to state income tax. But if the recipient of the income is not subject to state income tax, no tax is imposed either on the

pass through or on the non-taxable entity. This is not consistent with the purpose of pass through entities, which is not to create non-taxable income but to assure that taxable income is only taxed once and not at both levels. In addition, this business structure allows for non-taxable entities to conduct lines of business unrelated to their non-taxable business in pass through form tax free, whereas their taxable competitors in those lines of business must pay tax on the income earned by the pass through as well as the income they earn through their direct operations.

## **B. Operation of the Model Statute**

The model statute addresses the stated tax inequities by disregarding the federal tax treatment of pass-through entities and imposing state income tax directly on those entities. This equalizes the tax treatment of pass-through entities, irrespective of whether they are owned by entities that are subject to state income tax or not.<sup>6</sup>

## **IV. Summary of Written and Oral Comments and Recommendations**

1. The Trades recommend that the proposal be sent back to the subcommittee for further study. The Trades maintain, as they have throughout the project, that the imposition of state income tax on pass through entities that are related to insurance companies could subject the insurance companies to retaliatory tax. The Trades argue that the subcommittee has not adequately investigated the ramifications of this proposal on the insurance industry and on policyholders. The Trades suggest that the states lack the administrative capacity to deal with tax administration issues peculiar to the taxation of pass through entities. The Trades further contend that the states mistakenly believe that insurance companies pay less tax than non-insurance businesses and that the proposal would discriminate against insurance companies creating new inequities in state taxation.
2. NAREIT suggests that treating a REIT as a disregarded entity could result in double taxation. First, tax would be imposed on a lower tier disregarded entity of a REIT when it passes income to the REIT. Second, the REIT would be taxed again if it passed income on to a non-taxable entity.
3. Michael Fatale asserts that merely treating a REIT as a disregarded entity will not eliminate the tax inequity the proposal is designed to address, without also explicitly denying the REIT the dividend paid deduction.
3. Executive Director Stanislaus expressed her support for the proposal, as did Brenda Gilmer of Montana.

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<sup>6</sup> For reasons that are further explained below, the Hearing Officer recommends a somewhat different solution to the tax equity issue if the entity that passes the income through is a REIT. In such cases, the Hearing Officer recommends disregarding the dividend paid deduction if the REIT is owned by a non-taxable entity. In all cases the result is the same – tax would be imposed at the pass-through level.

4. Revenue Commissioner Bal outlined the purpose of and need for the proposal. She points out that corporate affiliates of insurance companies are currently subject to state income tax with apparently no resulting imposition of retaliatory tax.

## **V. Response to Witness Testimony**

### **1. Adequate Investigation**

The Trades assert that the Commission has not adequately studied the proposal, particularly by involving state regulators in the project to help in assessing the regulatory implications of the proposal. The Income and Franchise Tax Subcommittee has attempted to do so, throughout the history of the project. These efforts have met with limited success. In September 2008, the Hearing Officer invited the Maryland Insurance Commissioner to participate in the project.<sup>7</sup> The Maryland Insurance Commissioner suggested that the Hearing Officer contact the General Counsel of the National Association of Insurance Commissioners (NAIC) which the Hearing Officer did. Nevertheless, NAIC did not become involved. Similarly, MTC General Counsel Shirley Sicilian invited a NAIC representative to attend the subcommittee's meeting in March 2010. The representative expressed some interest, but did not ultimately attend.

Following the Subcommittee meeting in July 2010, the Hearing Officer spoke with Tracy Williams, Esquire, counsel for the Trades, who was attending the meeting. We discussed having an industry representative make a presentation to the subcommittee regarding how investments by insurance companies have changed since the 1980's. Subsequently, Ms. Williams indicated that the insurance trade associations she represents do not collect this information from their members and once again directed the MTC to NAIC. In an e-mail dated September 13, 2010, Ms. Williams offered to assist the subcommittee in meeting with insurance regulators. In a subsequent e-mail dated October 13, 2010, Ms. Williams instead suggested that an MTC member state, rather than MTC staff, should approach insurance regulators to solicit participation. In fact, there was one such contact in May 2010, when Gary Johnson of the Texas Comptroller's Tax Policy Division arranged a conference call between the Hearing Officer, Kevin Brady of the Texas Department of Insurance and himself, the purpose of which was to educate the Hearing Officer as to the meaning of the term "the business of insurance" as applied to an insurance company that also directly engages in a non-insurance business rather than doing so through an affiliate or pass through entity. This is the only successful contact with a regulator during the history of the project.

The initial focus of this project was quite broad. But the subcommittee greatly narrowed the current focus of the project to the partnership and disregarded entity issue at its meeting of October 7, 2009, with subsequent attention to be devoted to issues around overcapitalization. At that time, the subcommittee directed the drafting group to draft a statute to address the pass through issue. In narrowing the focus of the project, the subcommittee in effect also narrowed the regulatory implications of the project. Since

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<sup>7</sup> The Hearing Officer knows the former Maryland Insurance Commissioner, Ralph S. Tyler, as they worked together in the Maryland Attorney General's office.

October 2009 by far the most pertinent regulatory issue raised by the project has been whether subjecting the income of a pass through entity to tax would trigger retaliatory tax. While the subcommittee was unsuccessful in obtaining regulatory input on that question, as more fully explained below the Hearing Officer is satisfied, based on his own research and analysis of retaliatory tax caselaw, that it is extremely unlikely that taxing a non-insurance pass through on its own income would subject a related insurance company to retaliatory tax.

## **2. Retaliatory Tax**

The Trades suggest that imposition of state income tax on the entities subject to this proposal could expose out-of-state insurance companies to retaliatory tax to the extent that the insurer's home state adopts the proposal. In fact, Massachusetts attempted to address retaliatory tax concerns by modifying its original proposal to directly subject insurance companies to income tax to the extent those companies received income from partnerships and disregarded entities by imposing the tax instead at the partnership or disregarded entity level. The Trades objected to the modified proposal on the same grounds as they did the original.

The Hearing Officer has attempted to find any case where a state sought to impose retaliatory tax on an out-of-state insurer because the insurer's home state had imposed a tax on the income of a non-insurance affiliate of the insurance company. The Hearing Officer has been unable to find any such case, and no interested party has cited one.<sup>8</sup> As Commissioner Bal of the Massachusetts Department of Revenue points out in her letter of May 23, 2011, non-insurance corporate affiliates of insurance companies are currently subject to state income tax. Apparently, no state has ever imposed retaliatory tax on the affiliated insurance company because of that fact. The Hearing Officer finds no plausible reason why the result would be any different merely because the taxpayer is a partnership or disregarded entity for purposes of federal income tax. Presumably, the states will continue to honor the commonly accepted legal distinction between the legal incidence of a tax and the economic incidence of that tax and respect the separate business structures insurers have established to conduct their insurance and non-insurance operations.

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<sup>8</sup> During his July 2008 presentation, Gary Anderson cited the case of *First American Title Insurance Company, et al. v. Combs*, 258 S.W.3d 627 (Tex. 2008). In *First American Title Insurance*, the Texas Supreme Court held that the portion of title insurance premiums retained by title insurance agents as their fee could not be included in the computation of Texas premium tax for purposes of calculating the retaliatory tax. This had the effect of lowering the Texas premium tax attributable to foreign insurance carriers, thereby subjecting those foreign insurance carriers to Texas retaliatory tax. The Hearing Officer does not find *First American Title* to be on point as applied to the current proposal. First, the title insurance agents, unlike the disregarded entities that are the subject of the current proposal, were clearly engaged in the business of selling insurance. Second, the tax that "triggered" the imposition of retaliatory tax was the premium tax, which is the paradigmatic tax for which the retaliatory tax was created. Some portion of the premium tax would therefore always be used in the calculation of the retaliatory tax. The only question in *First American Title* was how much. The question presented in this case is whether an income tax imposed on non-premium income of a non-insurer should figure into the calculation at all, merely because the non-insurer is related to the insurer. For the reasons discussed in the text, the Hearing Officer believes it should not.

### **3. Administrative Capacity to Impose Tax on Partnerships and Disregarded Entities**

The Trades raise a number of issues in support of their contention that the states will be unable to administer a state tax imposed on partnerships and disregarded entities. But such a tax is not entirely unknown in the state tax area. For example, as Commissioner Bal notes, limited liability companies (LLCs), while afforded pass through treatment under federal law, are not always treated as pass through entities for various state tax purposes. While not without difficulty, there is no reason to believe that state tax administrators cannot devise methodologies and procedures for administering the pass through level tax that is presently being proposed.

### **4. Additional arguments raised by the Trades.**

Much of the Trades remaining arguments are predicated on a fundamental misunderstanding of the nature, purpose and effect of the proposal. Undergirding the Trades equitable arguments is the unstated assumption that the proposal is designed to tax an insurance company's investment income. This is simply not the case. As the proposal makes clear, it does not apply at all unless an insurance company owns, directly or indirectly, at least 50% of the capital or profits interest in a partnership or disregarded entity. The purpose of the 50% rule is precisely to preclude the proposal sweeping purely investment income within its scope. If an insurance company owns at least 50% of a non-insurance partnership or disregarded entity, it is more accurate to describe that business structure as allowing the insurance company to engage in two lines of business – insurance at the parent level and at least one non-insurance business at the lower tier levels.

Furthermore, the proposal imposes the tax, not on the insurance company's investment income but on the net income of the non-insurance lower tier entities.<sup>9</sup> It is the ability of insurance companies to engage in non-insurance businesses through partnerships and disregarded entities that creates an inequity in state tax treatment of such entities. If the partnership or disregarded entity is owned by a taxpayer that is subject to state income tax, state income tax is imposed on the entity to which the pass-through income flows. But if the partnership or disregarded entity is owned by an entity that is not subject to state income tax, the pass-through income is never taxed at all. The reason federal tax law allows for the creation of pass-through entities was to avoid double taxation of the same income, not to create tax-free income. This proposal is designed to address that inequity.

The Trades note, correctly, that gross premium tax often results in states receiving more revenue from insurance companies than would be the case under a net income tax; that difference inheres in the difference between a tax imposed on gross receipts and a tax that is measured by net income. But again, the proposal does not subject the insurance

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<sup>9</sup> It is a basic principle of tax law that a tax legally imposed on one entity is not treated as if it were legally imposed on another merely because the second entity incurs some or all of the economic effects of the tax.

company to an additional tax; it imposes the tax on the lower-tier entities. The fact that the entire enterprise ultimately pays more total tax -- the sum of premium tax paid by the insurer and income tax paid by the disregarded entities -- under the proposal than would a non-insurance business that uses a pass-through structure to realize income is because the insurance company is engaging in at least two lines of business (insurance and at least one non-insurance business) that are subject to two different tax regimes. And further, this result is no different than if the insurance company were a 50% owner of a corporation, under current law. Similarly, the inability to utilize net operating losses across the various components of the entire business enterprise is again a function of the fact that an insurance company that engages in a non-insurance business through a pass-through is engaging in two lines of business under two distinct tax regimes. To compare such an enterprise with a non-insurance business that utilizes a pass-through to realize income, all of which is subject to one tax regime, is to compare apples and oranges. Simply put, the issue this model addresses is not about insurance companies, the premium taxes they pay, or their overall tax burden. The issue is limited to pass-through entities, and whether the policy rationale for exempting these entities' income from corporate income tax applies under circumstances where the pass-through entities' income would escape tax altogether.

The Trades also assert that the proposal would result in policyholders bearing the economic costs of tax imposed as a result of investment income realized by variable insurance portfolios that are separately established for each policyholder. The Hearing Officer has difficulty seeing why this would be so. As the Trades point out in footnote 11 of their submission, the insurance company is merely the custodian of the policyholder separate accounts. The insurance company could not be the legal owner of the accounts because, among other things, that could subject the accounts to the claims of the insurance company's creditors. The insurer makes investments not for its own account, but for that of the policyholders. Consequently, the net income of the accounts does not, as the proposal requires, pass through to the insurance company. As a result, the investment income realized by the accounts would not be subject to the proposal.

In their supplemental comments, the Trades note that Massachusetts submitted testimony and materials emphasizing the potential implications of the proposal for captive insurance companies. The Trades argue that the proposal is broader than necessary to address any state tax concerns arising out of the captive insurance business model. The Hearing Officer wishes to once again emphasize that, whatever the potential implications of the proposal for captive insurance companies, the proposal is in fact intended and designed to address a broader concern than any issues that arise out of captive insurance companies. To reiterate, the proposal is designed to address a tax equity issue that inheres in **any** case where a non-taxable entity, such as a non-captive insurance company, receives income from a related partnership or disregarded entity. Irrespective of whether the business structure includes a captive insurance company, such a structure allows income to escape state taxation either at the disregarded entity level or at the non-taxable entity level. The proposal addresses that problem; a proposal specifically tailored to captive insurance companies would not.



## **5. Treatment of a real estate investment trust (REIT) as a partnership or disregarded entity**

The National Association of Real Estate Investment Trusts (NAREIT) objects to the inclusion of a REIT within the meaning of the term “partnership or disregarded entity”. NAREIT argues that treating a non-captive REIT as a partnership or disregarded entity could have the unintended consequence of creating double taxation, by subjecting lower tier partnerships or disregarded entities to state income tax to the extent their income flows through those entities to a REIT which claims a dividends paid deduction, while also imposing tax on the REIT to the extent the REIT’s income flows through to an entity that is not subject to state income tax. NAREIT urges that the proposal be modified to make explicit that a REIT is not to be considered a partnership or disregarded entity for purposes of the proposal.<sup>10</sup>

In its supplemental comments, NAREIT has proposed an alternative draft proposal that is designed to address the tax equity issue without at the same time treating a REIT as a partnership or disregarded entity. The Hearing Officer acknowledges that NAREIT was under no obligation to propose an alternative draft to the MTC. The Hearing Officer wants to thank NAREIT for going above and beyond in this matter. The Hearing Officer will further address NAREIT’s alternative draft in his recommendations that immediately follow.

Looking at the same issue from a different perspective, Michael T. Fatale, Chief, Rulings and Regulations Bureau of the Massachusetts Department of Revenue, asserts that the proposal does not go far enough, because it does not make explicit that a REIT’s dividends paid deduction should not be recognized to the extent that the dividends are attributable to income that is passed through to an entity that is not subject to state income tax. Merely characterizing the REIT as a partnership or disregarded entity would not by itself result in disregarding the deduction.

## **VI. Hearing Officer Recommendations**

The Hearing Officer believes, somewhat paradoxically, that both NAREIT and Mr. Fatale are correct – the Hearing Officer is of the view that the proposal as currently drafted is both underinclusive as noted by Mr. Fatale and overinclusive as noted by NAREIT.

It must be kept in mind that the intent of the proposal is to impose income tax once, but only once, on flow through income to an entity that is not subject to income tax. A REIT is subject to income tax, although its income is not in fact taxed to the extent it is paid out as a dividend subject to the dividends paid deduction. If the dividend is paid to an entity

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<sup>10</sup>NAREIT also makes a passing comment that the proposal does not define an entity that is not subject to income tax. However, the proposal instructs each state to list each such entity type with a citation to the state tax statute applicable to each.

that is subject to state income tax, that tax is imposed -- once -- on the dividend payee. If the dividend is paid to an entity that is not subject to state income tax, currently no income tax would be imposed at any level. The solution to that inequity is to disallow the dividends paid deduction and tax the income -- once -- at the REIT level. But defining a REIT as a partnership or disregarded entity could well have the effect of imposing tax twice, if the dividends paid deduction is disallowed -- once on the lower tier partnership or disregarded entity and once on the REIT. That is not the intent of the proposal. Therefore, the Hearing Officer proposes modifying the proposal in two ways.

1. To make explicit that for purposes of the proposal, a REIT is **not** to be treated as a partnership or disregarded entity.
2. To disallow the dividends paid deduction to the extent the dividends are attributable to income of the REIT that flows through to an entity that is not subject to state income tax.<sup>11</sup>

The Hearing Officer seriously considered NAREIT's proposed alternative draft. While generally responsive to the concerns expressed above, NAREIT's draft may be unduly narrow. The draft is limited to situations where the non-taxable entity owns the partnership or disregarded entity through another pass-through entity. This seems to limit the draft to multiple tier business structures and not to a situation where the non-taxable entity directly owns the payor disregarded entity. The Hearing Officer believes that his proposed alternative draft will result in tax being imposed once -- but only once -- on the disregarded entity or REIT that directly passes the income to the non-taxable entity. That should satisfy NAREIT's primary concern that a REIT's lower tier entities not be subject to tax. Of course, the REIT itself will be subject to tax to the extent it passes income through to a non-taxable entity.

In all other respects, the Hearing Officer recommends that the proposal be adopted as recommended by the Uniformity Committee.

Respectfully submitted,

Sheldon H. Laskin

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<sup>11</sup> The proposed changes are set forth in the Attachment to this report.

**Attachment**  
**(Hearing Officer proposed revisions are highlighted)**

**MTC proposed statute regarding partnership, pass-through entity or real estate investment trust (REIT) income that is ultimately realized by an entity that is not subject to income tax**  
**As Approved by the Income & Franchise Tax Uniformity Subcommittee**  
**As Submitted to Public Hearing March 10, 2011**

When 50 per cent or more of the capital interests or profits interest in an entity for which deductions would be allowed under section 162 of the Internal Revenue Code, 26 U.S.C. 162 and that would otherwise be treated as a partnership or disregarded entity for purposes of *[insert applicable state tax or taxes]* is owned, directly or indirectly, by *[identify each entity type that is not subject to income tax and that state wants to cover under this provision, such as “an insurance company,” with a citation to the state tax statute applicable to each such entity type]*, the net income *[or alternative tax base]* that passes through to such *[name each entity type identified above, e.g. “insurance company.”]* shall be taxed to the partnership or disregarded entity as if the partnership or disregarded entity were a corporation subject to tax under chapter *[insert state statute]* To the extent applicable, income that is taxable to the partnership or disregarded entity pursuant to this section, and any related tax attributes and activities, shall be included and taken into account in a combined report filed under *[insert state statute]*. As used herein, the term “partnership or disregarded entity” shall not include a real estate investment trust (REIT) within the meaning of Section 856 of the Internal Revenue Code of 1986, as amended.

When 50 per cent of more of the capital interests or profits interest in a real estate investment trust (REIT) as defined in section 856 of the Internal Revenue Code, 26 U.S.C. 856 is owned directly or indirectly, by *[identify each entity type that is not subject to income tax and that state wants to cover under this provision, such as “an insurance company,” with a citation to the state tax statute applicable to each such entity type]*, the dividends paid deduction to which the REIT is entitled under the Internal Revenue Code, to the extent attributable to dividends paid to such entity, shall not be recognized.