State of California
Franchise Tax Board

05.13.11

To: Sheldon H. Laskin, Multistate Tax Commission

From: Selvi Stanislaus

Proposed Statute Regarding Partnership or Pass-Through Entity Income That Is Ultimately Realized by an Entity That Is Not Subject to Income Tax

Memorandum

The California legislature has recognized that income can escape taxation through the use of entities completely exempt from the corporate franchise or income tax. For this reason, Revenue and Taxation Code section 24410 limits the deductibility of dividends received from an insurer as the insurer's income exceeds certain thresholds in relation to its written premiums. This phase-out of the dividends received deduction is designed to limit the tax benefits of corporations which overcapitalize or "stuff" their insurance subsidiaries. In addition, Revenue and Taxation Code section 24465 addresses transfers of property to an insurer by providing that any gain that would normally be subject to nonrecognition or deferral will generally be recognized upon the transfer.

The proposed Multistate Tax Commission (MTC) Model Statute also addresses these important issues. While it may not be possible for California to adopt the Model Statute, due to the language of the California Constitution, we are supportive of the MTC's effort and believe that this process should continue, in order to allow states that have not addressed these issues to consider doing so in a uniform manner.

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