



April 4, 2023

Delivered Via Email

Ms. Helen Hecht, Uniformity Counsel
Multistate Tax Commission Uniformity Committee
Partnership Tax Work Group
444 North Capitol Street, N.W., Suite 425
Washington, DC 20001

Re: Proposed Draft - Treatment of Investment Partnership Income

Dear Ms. Hecht and members of the Uniformity Committee:

PricewaterhouseCoopers LLP (“PwC”) hereby submits comments for consideration in drafting the Multistate Tax Commission (“MTC”) Uniformity Committee’s Proposed Draft model statute on the Treatment of Investment Partnership Income (the “Model Statute”). Comments provided here are based on the version of the Model Statute published on the MTC website on Aug 18, 2022. We understand the Model Statute remains in draft form and look forward to working with the MTC on any future revisions.

Definition of Qualifying Investment

We encourage the workgroup to consider adopting more conformity to existing US federal income tax statutes and regulations in relation to the “Qualifying Investment” definition included in the Model Statute.

IRC Section 864(b)(2) provides certain securities and commodities trading “safe harbors” for foreign investors. If a safe harbor test is met, a foreign investor is not considered to be conducting a trade or business in the United States for federal income tax purposes merely as a result of engaging in the activity covered by the safe harbor.

The federal foreign investor safe harbor exemptions provide a corollary to the type of state tax treatment that is being considered in the Model Statute (i.e., income that may be treated as being allocable to an individual income taxpayer’s domicile for state income tax purposes).

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However, IRC Section 864(b)(2) and the draft regulations issued thereunder provide a broader definition of qualifying investments than currently included in the Model Statute.

In addition to the items of note below, we also urge the MTC to consider adopting the safe harbors in whole to better align the state tax treatment with the underlying federal income tax provisions. Such conformity to the federal definitions and requirements would make the monitoring and compliance of state rules administratively simpler and allow flexibility for states to conform to future federal changes. To that end, we urge you to consider more consistency with the federal provisions noting in the model that such conformity is intended solely to apply to the Qualifying Investment definition to avoid any unintended consequences to unrelated statutes.

- Commodity Investments – As drafted, the Model statute focuses on investment “securities” when defining Qualifying Investments. We suggest that the MTC consider including commodity investments in the Model Statute. Commodity investments are covered by the previously noted IRC Section 864(b)(2) provisions. Further, commodity investments are treated similarly to security investments for federal income tax purposes under IRC Sections 475(f)(1) and 475(f)(2).

It appears in line with the MTC’s goals in drafting the Model Statute to source commodity investments as the income would be sourced if it had been earned directly by the ultimate taxpayer. Such treatment under the Model Statute would then be treated similarly to security investments for state income tax purposes if earned by an Investment Partnership. A number of existing state Investment Partnership statutes specifically reference commodities in their definitions (Connecticut, Illinois, New Jersey, and New York); thus, addressing commodities in the model statute would lead to further consistency across taxing jurisdictions.

- Foreign Currencies – We appreciate the inclusion of foreign currencies in the definition of Qualifying Investments in the most recent draft of the Model Statute. Foreign currencies meet the qualifying definitions in the previously mentioned IRC Section 475 definitions.
- Digital or Intangible Assets – We encourage the MTC to consider a broader definition of qualifying digital or intangible assets. In practice, taxpayers in the investment industry that appear to be the target for state Investment Partnership sourcing provisions invest

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in many types of intangible investments. As noted below, the US Department of Treasury recently has begun exploration of certain investment classes for US purposes. Certain of these arrangements may not have been in existence at the time state statutes and regulations were drafted by states with existing Investment Partnership provisions. As a result, the MTC Model Statute provides an opportunity for the modernization of existing state tax statutes.

In particular, we recommend the work group consider including references to investments in the following categories:

- Digital assets¹
 - Life insurance contracts purchased in the secondary market (i.e., stranger owned life insurance)
 - Revenue strips (i.e., contractual royalty/rent rights without ownership in the underlying assets)
 - Synthetic royalty deals (i.e., capital provided to a company in exchange for payments based on certain milestones being met, as is common in the life sciences industry).
- Derivative Securities – We encourage the MTC to provide a more detailed definition of the types of derivative securities that meet the Qualified Investment test. In general, for federal tax purposes, where investments in a certain asset class are intended to be covered under IRC Sections 475 or 864, the rules extend this protection to derivatives that reference such investments.
 - In defining the term “security.” IRC Section 475(c)(2)(E) provides the following language which may prove useful for this definition: *“evidence of an interest in, or a derivative financial instrument in, any security described in subparagraph (A), (B), (C), or (D), or any currency, including any option, forward contract, short position, and any similar financial instrument in such a security or currency.”*

¹ See the March 2022, Department of Treasury [General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals](#). Pages 102-103 provide a proposal to include a new “Digital Asset” class eligible for mark-to-market treatment under IRC Sec. 475.

Further note that IRC Sec. 6045(g)(3)(D) now includes a broad definition of a Digital Asset.

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- Proposed regulations under Treas. Reg. § 1.864(b)-1(b)(2) apply the security and commodity trading safe harbor to derivatives that reference securities or commodities. **Taxpayers may currently reasonably rely on these regulations.**

Debt Security Definition

We encourage the MTC to further refine the definition of debt security as provided in the Qualified Investments definition. The previously mentioned IRC Section 864(b)(2) provisions include a definition of debt security meeting the foreign trading safe harbor requirements. Broadly, for this purpose any instrument that is indebtedness for tax is considered a debt security. We urge the MTC to adopt the IRC Section 864(b)(2) provisions in defining debt securities. Alternatively, we recommend that the MTC clarify which types of loans would not be considered debt securities for purposes of meeting the Qualifying Investment definition with examples or more detailed definitions.

Testing Period for Qualified Investment Partnerships

The current Model Statute provides that a Qualified Investment Partnership must meet both an asset test and income test in addition to not being a dealer in the underlying investment. We request that the Model Statute provide more specificity around the procedures for each of the asset and income tests. For instance, must the asset test be met annually at the end of the tax year or also at interim periods during the tax year? Is the income test required to be met in full each year or is there a potential for more leniency in this test (i.e., two of the last three years)?

As an example, New York City provides a self-trading exemption from the general sourcing provisions in the city's Unincorporated Business Tax. NYC Admin. Code Section 11-502(C)(4)(D) provides a monthly averaging testing mechanism for purposes of the qualifying asset test.

More specificity in the testing mechanisms would allow Investment Partnerships to plan accordingly and help ultimate taxpayers in their structures to timely receive state income information, which would allow for more appropriate and timely tax reporting. Similarly, the move toward uniformity in this testing approach across state tax jurisdictions could provide more certainty for impacted taxpayers.

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Summary

Thank you for your consideration of the above comments. We appreciate the efforts of the MTC and the Partnership Project in particular to provide more conformity to state tax sourcing provisions in the Investment Partnership area. We would be glad to discuss our comments with you.

Sincerely,



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