



September 12, 2022

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Taxation of Partnerships  
c/o California Franchise Tax Board  
Rancho Cordova, CA 95741-1720

**RE: Draft Model Act on the [Treatment of Investment Partnership Income](#)**

Dear Ms. Hecht, Mr. Barber, and Ms. McElhatton:

The American Institute of CPAs (AICPA) is providing comments on the Multistate Tax Commission (MTC) [draft model act on the treatment of investment partnership income](#) (“draft model act”) (draft dated August 18, 2022) that is part of the MTC’s [Project on State Taxation of Partnerships](#) (“work group”). We appreciate that the MTC responded to our [letter](#) dated June 22, 2022, requesting a longer comment period, and allowed an adequate response period for our comments.

Overall, we believe the definitions and application of the rules for Qualified Investment Partnerships (QIP) in the MTC’s draft model act are narrower and more restrictive than the statutory frameworks currently enacted in many states. We recommend updating the language in the MTC’s draft model act to match the less restrictive statutory frameworks currently enacted in many states that have already adopted QIP rules by addressing the below issues in its final language of Model Act on the Treatment of Investment Partnership Income.

1. Do not broadly exclude a dealer in qualifying investments in the definition of Nonresident QIP.
2. Update the proposed language of the definition of a QIP to include both tangible personal property and intangible personal property reasonably necessary to carry on its investment activities.
3. Clarify that Qualified Investments include investments in gold, other precious metals, gems, and collectibles and consider addressing investments in non-captive REITs and RICs.
4. Clarify the definitions of a “Loan” and a “Debt Security.”
  - A. Provide more specific definitions for a “Loan” and a “Debt Security” in order to clarify the type of loans not included in the definition of Qualified Investments.

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- B. Follow the federal income tax treatment of financial instruments and treat as stock under the model act a debt instrument that is treated as an equity investment for Federal income tax purposes.
  - C. Treat notes, mortgages, receivables and other forms of debt purchased on a secondary market as meeting the definition of a debt security considered a Qualified Investment.
  - D. Clarify that accounts receivable with brokers, dealers, and trading partners are either debt securities or are considered an asset necessary to the business of a QIP.
5. Do not require detailed lists of information in information returns to be filed by QIPs.
6. Provide that to the extent a lower-tier partnership (LTP) is required to file a state partnership return in the partner's residence state, a LTP is required to explicitly state (on the state Schedule K-1 or wherever appropriate) that it met the qualified investment partnership definition.

Our recommendations are detailed and explained further below.

### **1. Do Not Broadly Exclude a Dealer in Qualifying Investments in the Definition of Nonresident QIP**

In its definition of a Nonresident QIP Partner, the proposed language excludes a Dealer in Qualifying Investments. We believe the definition of a Nonresident QIP Partner should not broadly exclude any individual or entity that meets the definition of a Dealer in Qualifying Investments if that individual or entity is not otherwise involved in the management of the QIP and if their investment in the QIP is unrelated to their business as a Dealer in Qualifying Investments.

As an alternative, we believe the MTC should consider language similar to [35 Ill. Comp. Stat. 5/305\(c-5\)](#), which generally provides that the investment partnership rules should not apply:

[I]f such income is from investment activity:

- that is directly or integrally related to any other business activity conducted in this State by the nonresident partner (or any member of that partner's unitary business group);
- that serves an operational function to any other business activity of the nonresident partner (or any member of that partner's unitary business group) in this State; or
- where assets of the investment partnership were acquired with working capital from a trade or business activity conducted in this State in which the nonresident

partner (or any member of that partner's unitary business group) owns an interest.<sup>1</sup>

**2. Update the Proposed Language of the Definition of a QIP to Include Both Tangible Personal Property and Intangible Personal Property Reasonably Necessary to Carry on Its Investment Activities**

In its definition of a QIP, the proposed language includes the requirement that “[n]o less than 90 percent of the cost of the partnership’s total assets consists of Qualified Investments and the office facilities and tangible personal property reasonably necessary to carry on its investment activities.” We believe the requirement should also reference intangible personal property reasonably necessary to carry on its investment activities, such as software or seats on a stock exchange. Specifically, we believe the proposed language should be updated to include both tangible personal property and intangible personal property reasonably necessary to carry on its investment activities.

**3. Clarify that Qualified Investments Include Investments in Gold, Other Precious Metals, Gems, and Collectibles and Consider Addressing Investments in Non-Captive REITs and RICs**

In its definition of Qualified Investments, we believe the language should clarify that Qualified Investments include investments in gold, other precious metals, gems, and collectibles and should consider addressing investments in non-captive REITs and RICs.

**4. Clarify the Definitions of a “Loan” and a “Debt Security”**

**A. Provide More Specific Definitions for a “Loan” and a “Debt Security” in Order to Clarify the Type of Loans Not Included in the Definition of Qualified Investments**

We believe the proposed language should provide more specific definitions for a “loan” and a “debt security” to clarify the type of loans not included in the definition of Qualified Investments. The proposed language treats debt convertible into stock as a Qualified Investment. However, a conversion feature is not the sole criteria for treating a debt as an equity (stock) investment for federal income tax purposes.

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<sup>1</sup> [35 Ill. Comp. Stat. 5/305\(c-5\)](#).

**B. Follow the Federal Income Tax Treatment of Financial Instruments and Treat as Stock under the Model Act a Debt Instrument that is Treated as an Equity Investment for Federal Income Tax Purposes**

The Model Act should follow the federal income tax treatment of financial instruments, so that a debt instrument that is treated as an equity investment for federal income tax purposes is also treated as stock under the Model Act.

**C. Treat Notes, Mortgages, Receivables and Other Forms of Debt Purchased on a Secondary Market as Meeting the Definition of a Debt Security Considered a Qualified Investment**

We believe notes, mortgages, receivables and other forms of debt purchased on a secondary market should meet the definition of a debt security considered a Qualified Investment. Many states with QIP rules specifically make it clear that mezzanine debt, loan participations, repurchase agreements, and asset-backed securities meet the definition of a debt security considered a Qualified Investment.

**D. Clarify that Accounts Receivable with Brokers, Dealers, and Trading Partners are Either Debt Securities or are Considered an Asset Necessary to the Business of a QIP**

The proposed language should also make it clear that accounts receivables with brokers, dealers, and trading partners are either debt securities or are considered an asset necessary to the business of a QIP.

**5. Do Not Require Detailed Lists of Information in Information Returns to be Filed by QIPs**

The proposed language in Section 4 related to the authority delegated to the state to issue regulations and other guidance to carry out these rules includes requirements for information returns to be filed by QIPs, including requirements to provide “lists of partner names and addresses, lists of investments or other investment information, lists of other assets and their values, and similar records.” We believe requiring this type of information may be an administrative burden for certain taxpayers with high frequency trading funds, particularly if this information is required to be provided on an annual basis. The volume of information and time required to process such information may also be an administrative burden on the state tax departments. Additionally, certain taxpayers will prefer not to disclose such information to protect investment strategies or investor confidentiality. The requirement of such details and lists should not be included.

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**6. Provide that to the extent a lower-tier partnership (LTP) is required to file a state partnership return in the partner’s residence state, a LTP is required to explicitly state (on the state Schedule K-1 or wherever appropriate) that it met the qualified investment partnership definition.**

The definition of qualified investments includes interests in another partnership (lower-tier partnership or LTP) if it itself meets the requirement to be treated as a qualified investment partnership. That is similar to the federal tax rule to determine whether an interest in a LTP is treated as a qualified asset for section 704(c) aggregation purposes. In practice, certain partnerships may not be provided information from the LTP on a Schedule K-1 to indicate whether it itself is a qualified asset and may not know enough about the LTP to know whether it met the 90% test. In tiered structures, it is often difficult to obtain timely, if at all, insight into details from lower-level tiers, and there is a great amount of disparity amongst the information states require to be provided on Schedule K-1s. We suggest the model act should provide that to the extent a LTP is required to file a state partnership return in the partner’s residence state, a LTP is required to explicitly state (on the state Schedule K-1 or wherever appropriate) that it met the qualified investment partnership definition.

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We appreciate your consideration of our request and welcome the opportunity to discuss this request and the draft model act further. If you have any questions, please contact Mo Bell-Jacobs, Chair, AICPA State and Local Tax Technical Resource Panel, at (202) 370-8175 or [Mo.Bell-Jacobs@rsmus.com](mailto:Mo.Bell-Jacobs@rsmus.com); Eileen Sherr, AICPA Director – Tax Policy & Advocacy, at (202) 434-9256 or [Eileen.Sherr@aicpa-cima.com](mailto:Eileen.Sherr@aicpa-cima.com); or me at (601) 326-7119 or [JanLewis@HaddoxReid.com](mailto:JanLewis@HaddoxReid.com).

Sincerely,



Jan Lewis, CPA  
Chair, AICPA Tax Executive Committee

cc: Mr. Gregory S. Matson, Executive Director, Multistate Tax Commission