

## COMMENT LETTER

July 24, 2018

# ICI Submits Comment Letter on NYS UBT Proposal (pdf)

By Electronic Delivery July 16, 2018 NYS Department of Taxation and Finance W.A. Harriman Campus, Building 9, Room 200 Albany, NY 12227

federal.tax.response.comments@tax.ny.gov RE: NYS Unincorporated Business Tax Dear Sir or Madam: The Investment Company Institute<sup>1</sup>—on behalf of shareholders in all funds, including mutual funds, that are registered under the Investment Company Act of 1940 (1940 Act)—strongly recommends that any state-level unincorporated business tax (UBT) be optional. At a minimum, any state-level UBT should include the exemptions provided in the New York City UBT—including the exemption for business activities of taxpayers who purchase and sell property for their own account.<sup>2</sup> Fund investors would be harmed, were their funds required to pay UBT, because funds cannot pass-through state tax credits to their investors. Background Funds are investment pools typically utilized by investors of moderate means who are saving for retirement or other long-term needs.<sup>3</sup> Most funds have investors located in all fifty states. 1 The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US\$22.0 trillion in the United States, serving more than 100 million US shareholders, and US\$7.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC. 2 Illinois also exempts investment partnerships (e.g., master funds) from entity-level taxation. See IITA §201(c)-(d) and §205(b). 3 The typical fund investor is a middle-class American with a median household income of \$100,000 and modest holdings. The most recent ICI data show median mutual fund assets of \$120,000 per household in three accounts. [https://www.ici.org/pdf/2018\\_factbook.pdf](https://www.ici.org/pdf/2018_factbook.pdf), Figure 7.2. ICI Letter NYS UBT Proposal July 16, 2018 Page 2 of 3 Approximately half of all fund assets are held in retirement accounts and, as such, are not taxed currently or are funded with post-tax income.<sup>4</sup> Funds are corporations for tax purposes, but, unlike most corporations, they generally do not incur federal income tax on their income or capital gains if they meet certain gross income and asset requirements and distribute their income annually. Funds deduct the shareholder distributions and zero out their taxable income (dividends paid deduction). Funds also normally do not pay state income taxes since states typically base taxable income on federal income. All federal and state income tax on a fund's income, therefore, is incurred at the fund investor level (either when the fund dividend is received or, subsequently, when the investor takes a distribution from a retirement account).<sup>5</sup> Funds sometimes use

partnerships in their investment structures (e.g., master-feeder structures) to maximize portfolio trading efficiencies. In a typical master-feeder structure, each fund (i.e., feeder fund) invests all its assets in a partnership (i.e., master fund); all portfolio investments are made at the master fund level. No Pass-Through of State Tax Credits The Department's January 2018 preliminary report that discusses UBT options provides that the tax imposed on a partnership could be credited up to the full value of the entity-level tax to the owners of a partnership against their personal income taxes. This objective would not be achievable for fund investors, however, as there is no mechanism to allow for the pass through of credits for state taxes paid by a fund (or a master fund) to fund shareholders. In contrast, there is a statutory mechanism in section 853 of the Internal Revenue Code that permits funds to pass through foreign tax credits to their shareholders. Unless there were a similar statutory mechanism available at the state level, that was adopted by all states, a fund would be unable to provide a similar pass-through of state tax credits to its shareholders. Any state tax incurred today is a deductible expense that reduces a fund's investment company taxable income and the amount it must distribute. While this deduction provides some economic relief to taxable shareholders, it is not as beneficial as a tax credit which reduces a taxpayer's tax liability dollar- for-dollar. Moreover, the deduction provides little or no benefit to investors saving for retirement through tax-deferred or after-tax retirement accounts as these accounts are exempt from federal and state tax until withdrawal. Consequently, imposing a state-level UBT on funds that invest in master fund partnerships would not alleviate the burden for New York residents that are subject to the new federal \$10,000 state tax 4 47% of all mutual fund assets (\$8.8 trillion of \$18.7 trillion) are held in individual retirement accounts (IRAs) and defined contribution (DC) plan accounts. See 2018 Investment Company Fact Book, inside cover (2017 Facts at a Glance). 5 Investors in a Roth retirement account contribute to funds with post-tax income (no deduction on contributions) and are not taxed on future withdrawals. ICI Letter NYS UBT Proposal July 16, 2018 Page 3 of 3 deduction limitation. Instead, the tax will reduce investment returns by imposing additional tax with no credit offset to investors. Recommendation The Institute strongly recommends that any state-level UBT be optional. Alternatively, at a minimum, the proposal should incorporate the same exemptions that apply to the New York City UBT. The unintended (and most unfortunate) consequence of this proposal, without modification, would harm the proposal's intended New York beneficiaries. \* \* \* \* \* The Institute appreciates your consideration of our concerns. Please do not hesitate to contact the undersigned at (202) 326-5826 if you have any questions regarding this letter or would like any additional information regarding the organization, operation, or taxation of investment companies and/or their shareholders. Sincerely, Katie Sunderland Counsel - Tax Law