

Metro Business Income Tax Administrative Rule 7.07 – 1011

7.07 – 1011 Diversified Investing Fund Deduction

Currently, a federal and Oregon tax deduction exists for Regulated Investment Companies (i.e., mutual funds) that allows the individual owner to pay tax on the earnings from the mutual fund investments as opposed to the mutual fund paying the tax itself. Similar investment funds (Diversified Investing Funds), while not meeting the requirements for the federal deduction, will be allowed to take a similar deduction to determine net income under the Business Income Tax.

For purposes of this rule, a Diversified Investing Fund is a limited partnership or limited liability company that is classified as a partnership for federal income tax purposes and that meets all of the following requirements:

- (1) Is formed and operated for the primary purpose of buying, holding, or selling qualifying investment securities, on its own behalf and not as a broker, and the capital of which fund is primarily (more than 50%) derived from investments by entities or individuals which are neither related to nor affiliated with the fund except in the capacity as investors that do not actively participate in the management of the fund;
- (2) No less than ninety percent (90%) of the diversified investing fund's cost of its total assets consists of qualifying investment securities, deposits at banks or other financial institutions, and office space and equipment reasonably necessary to carry on its activities as a diversified investing fund; and
- (3) No less than ninety percent (90%) of its gross income consists of interest, dividends, pass-through income, and gains from the sale or exchange of qualifying investment securities.

“Qualifying investment securities” include all of the following:

- (a) Common stock, including preferred or debt securities convertible into common stock, and preferred stock;
- (b) Bonds, debentures, and other debt securities;
- (c) Foreign and domestic currency deposits or equivalents and securities convertible into foreign securities;
- (d) Mortgage- or asset-backed securities secured by federal, state, or local governmental agencies;
- (e) Repurchase agreements and loan participations;
- (f) Foreign currency exchange contracts and forward and futures contracts on foreign currencies;
- (g) Stock and bond index securities and futures contracts, and other similar financial securities and futures contracts on those securities;
- (h) Options for the purchase or sale of any of the securities, currencies, contracts, or financial instruments described in clauses (a) to (g), inclusive;
- (i) Regulated futures contracts; and
- (j) Interests in a limited partnership or limited liability company, if classified as a partnership for federal income tax purposes.

This deduction is limited to the amount of interest, dividends, pass-through income, and gains from the sale or exchange of qualifying investment securities.

Example 1:

VC Fund, LP (the Fund), a venture capital investment fund, is managed by VC Management, LLC (the Manager), a venture capital firm. The Manager and the Fund are located within the Metro district. The Manager receives funds from outside investors and deposits them into the Fund. The Fund pays the Manager fees for managing the investments and administering the funds. The Fund meets the requirements to be considered a Diversified Investing Fund.

The Manager must file and pay the Business Income Tax based on the net income of the LLC, if gross receipts exceed \$5 million. Their net income would include the management fees from the Fund.

The Fund must file and pay the Business Income Tax based on the net income of the LP, but it is allowed a deduction equal to the otherwise taxable net income that can be attributed to the investment income. The applicable minimum fee would be based on the gross income before the deduction. No deduction for net income from the Fund's investment in a partnership shall be allowed, to the extent that the Fund claims an exclusion for such income as pass-through income pursuant to Administrative Rule 7.07 - 1061 (Treatment of Currently Taxed Pass-Through Income). In other words, the Fund cannot take a deduction for income that it has already excluded or reversed from its income.

Diversified investing funds often are structured so that a member of the fund (typically, the fund's general partner in the case of a fund organized as a limited partnership) is entitled to a percentage interest in the fund disproportionate to its invested capital. The additional interest is referred to as the "carried interest" or the "carry." The following example illustrates one possible circumstance in which income attributable to a carried interest is not subject to the Business Income Tax:

In the example above, assume that the Fund's general partner is a business entity that contributes 1% of the invested capital. The general partner also is entitled to a 20% interest (a "carried interest") in profits after all investors receive a specified rate of return on their invested capital. The sole activity of the general partner is to make investment decisions on behalf of the Fund, and to engage and monitor the services of the Manager implementing those decisions. The general partner has its commercial domicile inside the Metro district and conducts its activities inside the Metro district. In this example, both the income attributable to the 1% investment and the income attributable to the carried interest are reversed from the general partner's Metro return and therefore are not subject to the Business Income Tax pursuant to Administrative Rule 7.07 – 1061 (Treatment of Currently Taxed Pass-Through Income).

If a Diversified Investment Fund which is otherwise entitled to the deduction, disqualifies itself from the deduction as a result of an unusual or extraordinary transaction occurring during startup or wind-down, they may petition the Administrator to allow the deduction. The Administrator may then allow the deduction or a portion of the deduction at its discretion.

Note: Applies to tax years beginning on or after 1/1/2023.

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