VII. Summary of Multistate Research On State Tax Sourcing for Complex Partnership Structures

Information in this section comes from state statutes, regulations, cases, form instructions, and guidance as of the date of this draft. This information should not be relied on as tax advice. For specific questions, taxpayers should contact the applicable state department of revenue or their tax advisor.

Since the federal partnership rules do not address state tax sourcing rules for complex partnership structures, state specific rules provide necessary clarity. This section summarizes the rules in states that have addressed sourcing in complex partnership structures specifically. But many of the states have not yet explicitly addressed these structures or provided clarity on the full range of potential issues.

VII. A. Summary of Complex Partnership Structure Sourcing Issues Addressed by States

State sourcing rules for complex partnership structure take varying approaches with varying levels of detail and clarity. This subsection VII. A. summarizes issues states have explicitly addressed in their sourcing rules for complex partnership structures and analyzes the current status of state rules on these issues. The specific state provisions are set forth in Section VII. B. below.

Are attribution and conduit principles involved in state tax sourcing for complex partnership structures?

Most of the states conform to the federal partnership principals on attribution and the determination of an item's character at the partnership level. However, a few states, such as Massachusetts and California also have specific language clarifying that the determination of whether an item is apportionable or non-apportionable income takes place at the partnership level. Some states (such as Colorado, Indiana, Massachusetts, Montana, New York, and Virginia) further clarify that the partnership level attribution flows through multiple tiers of owners.

Have the states addressed sourcing when a complex partnership structure includes a corporate partner?

When a corporation owns an interest in a partnership structure, most states have specifically addressed how the corporation should source its share of income that is apportionable to the partnership. The majority of states (including Alabama, Arizona, California, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Indiana, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Jersey, New York, North Carolina, North Dakota, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, Virginia, West Virginia, and Wisconsin) use formulary apportionment and blend the apportionment factors of the corporation with the corporation's pro rata share of the apportionment factors of the partnership. However, several states expressly limit blended apportionment to situations where there is a unitary relationship (California, Hawaii, Indiana, Illinois, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Jersey, Vermont, West Virginia, Wisconsin); apportionable income (Idaho, North Carolina, North Dakota), or a business interest (Alabama – business interest, Arizona – business interest, Iowa - connection with the taxpayer's regular trade or business operations, Oregon - part of the corporation's overall business operations). For non-unitary partnerships in these states, the income is generally sourced at the partnership level and that sourcing is retained as it flows up without reapportionment. If the income is non-apportionable to the partnership, states generally source that income using rules of assignment at the entity level and that sourcing is then attributed to the partners.

Have the states addressed sourcing when a complex partnership structure includes multiple levels of partnerships?

When an upper-tier partnership owns an interest in a lower-tier partnership, only 13 states have specifically addressed how the upper-tier partnership should source its share of income that is apportionable to the lower-tier partnership. Ten of these states (Arizona, California, Colorado, Florida, Illinois, Kentucky, Massachusetts, Utah, West Virginia, and Wisconsin) have express provisions using formulary apportionment and blending the apportionment factors of the upper-tier partnership with its pro rata share of the apportionment factors of any lower-tier partnerships. California, Colorado, Illinois, Massachusetts, West Virginia, and Wisconsin limit the blended apportionment to situations involving a unitary relationship. For non-unitary partnerships in these states, the income is generally sourced at the lower-tier partnership level and that sourcing is retained as it flows up without reapportionment. New Jersey, New York, and Montana do not use blended apportionment when there are multiple levels of partnerships. Instead, the income is sourced at the level of the lower-tier partnership and that sourcing is retained as it flows through to the upper- tier partnerships. If the income is non-apportionable to the lower-tier partnership, states generally source that income using rules of assignment at the entity level and that sourcing information is then attributed to the partners.

Have the states defined what a pro rata share is for purposes of blended apportionment?

Only 6 states have expressly defined what a pro rata share is for purposes of blended apportionment. Massachusetts and Maine generally look to the profit and loss percentage but have exceptions for certain gains/losses and changes of interest. Idaho and West Virginia look to the distributive share of partnership income or losses. Oregon uses a ratio involving capital accounts and related entity debt. Finally, Pennsylvania indicates that the pro rata share of apportionment factors shall be determined under the partnership agreement and in accordance with the Internal Revenue Code.

Have the states addressed how intercompany transactions should be treated in the apportionment factor in complex partnership structures?

States vary on whether intercompany transactions must be eliminated from the apportionment factors in complicated structures. Some examples of states with express provisions where certain intercompany sales are excluded include California, Hawaii, Idaho, Indiana, Maine, Massachusetts, Michigan, Nebraska, New Jersey, and Oregon.

Have the states addressed how special allocations should be treated in complex partnership structures?

Most of the states conform to the federal partnership principals on substantial economic effect. Several states (Connecticut, Kansas, Louisiana, Maine, Missouri, New York, Rhode Island, Virginia, West Virginia, and Wisconsin) also expressly state that a special allocation will be disallowed if the principal purpose is to avoid or evade *state* tax.

Have the states addressed whether alternative apportionment applies when there are complex partnership structures?

Several states (Arkansas, Florida, Illinois, Kansas, Maryland, Massachusetts, New Jersey, North Carolina, Ohio, Rhode Island, Tennessee, Virginia and West Virginia) have alternative apportionment provisions that are expressly applicable when partnerships are involved and the requirements for alternative apportionment are otherwise met. In addition, some state alternative apportionment rules are applicable to "taxpayers." If a state includes partnerships in their definition for taxpayers, alternative apportionment could be applicable if the statutory requirements are otherwise met.

IV. B. State Rules on Sourcing for Complex Partnership Sourcing

This subsection IV. B. sets forth the detailed rules in states that have explicitly addressed sourcing for complex partnership structures in statutes, regulations, cases, form instructions, or guidance.

Alabama

Ala. Admin Code r. 810-27-1-.09(3)

> For taxpayers with a business interest in an unincorporated entity (e.g., partnership, unincorporated joint-venture, limited liability company taxed as a partnership, etc.), the apportionment formula shall include the pro rata share of the unincorporated entity's factor data.

Alaska

Alaska Form 6900 Instructions from 2022

> A partnership is required to file Form 6900, even if the partnership itself does not conduct business in the state, but owns a partnership interest in a lower-tier partnership doing business in the state, because of the attribution rule . . . Nexus is sometimes referred to as "doing business" within the state. It is the act of conducting business activity within the state during the tax year. It may exist as a result of an entity's direct activity, the activity of its employees or agents, or through its interest in a lower-tier partnership or LLC . . . A lower-tiered partnership is required to file Form 6900 if it has nexus in Alaska and any partner is a corporation or another partnership, even if the partners of the higher-level partnership are all natural persons or those effectively treated as natural persons . . . Indicate whether the partnership has an ownership interest in any foreign partnership. Attach a schedule showing the name, EIN, and the ownership percentage held of each foreign partnership. If the foreign partnership has an ownership interest in a foreign corporation, the ownership is attributed to the upper- tier partnership, including all tax attributes such as apportionment factor . . . If you answered yes to question 1c on page 1 of Form 6900, then the amounts in Schedule A, column A must include amounts attributed to the partnership from lower-tier partnerships.

Alaska Admin. Code tit. 15, § 20.320(a)

> The income, expenses, assets, and apportionment factors of an enterprise involving undivided joint ownership must be attributed to the joint owners of that enterprise on the basis of their respective ownership interests, as may be modified by agreement among those joint owners. For purposes of this section, partnerships, joint ventures, trusts with joint beneficiaries and similar legal entities but not a single corporation, are enterprises involving undivided joint ownership.

Arizona

Ariz. Rev. Stat. Ann. § 43-306

> The allocation and apportionment of income of a partnership that has nonresident partners shall be made pursuant to chapter 11, article 4 of this title.

Arizona Corporate Tax Ruling No. 93-9 (04/30/1993)

A multistate corporation that has a partnership interest in a partnership that is a partner in a tiered partnership must also report its ultimate distributive share of the tiered partnership's income or loss from Arizona activities.

Example:

Partnership A has a 50% apportionment ratio for its Arizona operations. Partnership B has a 25% interest in Partnership A. Corporation C has a 10% interest in Partnership B. Partnership B does not have any other connection with Arizona other than its partnership interest. Corporation C has business activities within and without Arizona in addition to its partnership interest in a partnership that is a partner in a tiered partnership.

Corporation C must file an Arizona corporate income tax return apportioning its income from business activities within and without Arizona. Corporation C must also report its ultimate distributive share of Partnership A's Arizona income, loss, gain and other items. If Corporation C has a business partnership interest in Partnership B, the corporation will apportion its income or loss from the tiered partnership. If Corporation C has a nonbusiness partnership interest in Partnership B, the corporation will allocate its income or loss from the tiered partnership.

Arizona Corporate Tax Ruling No. 93-10 (04/30/1993)

A corporation that does not have any connection with Arizona, other than a partnership interest in a partnership that is a partner in a tiered partnership, must apportion or allocate its ultimate distributive share of the tiered partnership's income or loss from Arizona activities. If the corporation's interest in the tiered partnership is business, the numerator and denominator of the corporation's apportionment factors in the Arizona tax return would include the corporation's distributive share of the tiered partnership's factors. The allocation of a tiered nonbusiness partnership's income or loss in the corporation's Arizona tax return would reflect the corporation's ultimate distributive share of the tiered partnership's Arizona activities.

A multistate corporation that has business activities within and without Arizona must apportion its income from such activities in addition to the apportionment or allocation of its ultimate distributive share of the tiered partnership's income or loss from Arizona activities. If the corporation's interest in the tiered partnership is business, the numerator and denominator of the corporation's apportionment factors in the Arizona tax return would include the corporation's distributive share of the tiered partnership's factors. The allocation of a tiered nonbusiness partnership's income or loss in the corporation's Arizona tax return would reflect the corporation's ultimate distributive share of the tiered partnership's Arizona activities.

Arizona DOR Publication No. 713 (2/1/2023)

Example of a Partnership Using a Special Allocation
The PTE Credit and PTE Taxes Paid are allocated to the partner based on his/her proportionate share of income that is attributable to that partner for Arizona tax purposes. For example, if the taxable income of a partner is 60% of the partnership's taxable income, that partner is entitled to 60% of the PTE Credit, and 60% of the PTE taxes paid by the partnership.

NOTE: The total of all PTE Credits or PTE taxes paid that is distributed to the partners cannot exceed the maximum amount of the credit or the total amount of PTE taxes paid.

EXAMPLE: A partnership has two partners, A & B. The partnership made the PTE election. Both partners, A & B did not opt out of the PTE election. The partnership's Arizona taxable income for the year is $100,000. Due to a special allocation, Partner A's

distribution of the partnership income is $120,000. Partner B's distribution is ($20,000). The partnership's PTE tax credit for the year is $2,980 ($100,000 * 2.98%).

Partner A's pass-through PTE tax credit is $2,980.

Partner B does not receive a pass-through of the PTE tax credit.

NOTE: If a partnership uses a special allocation to distribute partnership income rather than ownership share, complete Schedules D and E of Form 165 using that special allocation method for each partner.

Arkansas

Ark. Code Ann. § 26-51-802(c)

A partnership that files an Arkansas partnership return and has income from both within and without Arkansas shall apportion income to Arkansas under the Uniform Division of Income for Tax Purposes Act, § 26-51-701 et seq.

Subject to the provisions of § 26-51-202(e), all partnership income from activities within this state that is reflected on a partnership return shall be allocated to this state.

Ark. Corp. Inc. Tax Regs. 1.26-51-802(b)

Any taxpayer with an interest in a partnership which has gross income from sources within Arkansas must directly allocate the partnership's Arkansas income to Arkansas, rather than include partnership income and apportionment factors in the taxpayer's apportionment formula.

2023 Form AR1050 Instructions – Partnership Income Tax

If the allocation and apportionment provisions as set out above do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the Commissioner of Revenue, Department of Finance and Administration may require in respect to all or any part of the taxpayer's business activity, if reasonable:

A) Separate accounting
B) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State, or
C) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

A petition must be a formal written request submitted to and approved by the Department of Finance and Administration prior to the filing of a return using the proposed method. The approval letter should be attached to all returns filed using the approved alternative apportionment method.

California

Cal. Code Regs. tit. 18, § 25137-1

When a taxpayer has an interest in a partnership as defined in Section 17008, Revenue and Taxation Code, the division of its distributive share of partnership items shall be determined in accordance with Chapter 10 of Part 10 of Division 2 of the Revenue and Taxation Code. The determination of the portion of such distributive share (constituting business and nonbusiness income) which has its source in this state or which is

includible in the taxpayer's business income subject to apportionment, shall be made in accordance with these regulations provided that the taxpayer, or the partnership, or both, have income from sources within and without this state. The taxpayer in computing net income for its taxable year shall include its distributive share of partnership items referred to above for any partnership year ending within or with the taxpayer's taxable year. The same principle applies when a taxpayer has an interest in a partnership that itself owns an interest, directly or indirectly, in one or more other partnerships.

The first step is to determine which portion of the taxpayer's income and its distributive share of the partnership items constitute "business income" and "nonbusiness income" under Section 25120, Revenue and Taxation Code, and the regulations thereunder. The various items of nonbusiness income are then directly allocated to specific states pursuant to the provisions of Section 25124 to 25127, Revenue and Taxation Code. The taxpayer's distributive share of partnership business income is apportioned by the formula set forth in subsections (f) or (g), whichever is applicable. Even if the partnership's business and the taxpayer's business are not unitary, such that subsection (g) applies, the distributive share of income allocated to the taxpayer is from a separate trade or business of the taxpayer, not nonbusiness income of the taxpayer. The determination of whether an item of income is apportionable business income or allocable nonbusiness income is made at the partnership level based on the trade or business of the partnership. Revenue and Taxation Code section 23040 is not applicable. The sum of (1) the items of nonbusiness income directly allocated to this state, plus (2) the amount of business income attributed to this state is the portion of the taxpayer's entire net income which is subject to tax.

Income arising from transactions and activity in the regular course of the partnership's trade or business constitutes business income. Thus, a corporate-partner's distributive share of partnership business income constitutes business income to the corporate-partner, but the determination of whether the partnership's activities and the activities of the corporate-partner constitutes a single trade or business or more than one trade or business turns on the facts in each case. If the partnership's activities and the taxpayer's activities constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be combined with the taxpayer's trade or business as constituting a single trade or business . . . When the activities of the partnership and the taxpayer do not constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be treated as a separate trade or business of the taxpayer.

(f) If the partnership's activities and the taxpayer's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of such single trade or business attributable to this state shall be determined by an apportionment formula, pursuant to either Section 25128, Section 25128.5 or Section 25128.7, Revenue and Taxation Code, whichever is applicable, of the taxpayer and its share of the partnership's factors for any partnership taxable year ending within or with the taxpayer's taxable year . . .

(f)(3)(A) The partnership's sales which give rise to business income, shall be included in the denominator of the taxpayer's sales factor to the extent of the taxpayer's interest in the partnership. The amount of such sales attributable to this state shall also be included in the numerator of the taxpayer's sales factor. Intercompany sales between the partnership, on the one hand, and the taxpayer or any member of the taxpayer's combined reporting group, on the other, shall be eliminated from the denominator of the taxpayer or the taxpayer's combined reporting group (if applicable), as well as the numerator of the taxpayer's sales factor or the numerator of another member of the taxpayer's combined reporting group, whomever made the sale to the partnership, as follows:

(i) Sales by the taxpayer, or any member of the taxpayer's combined reporting group, to the partnership to the extent of the taxpayer's interest in the partnership.

(ii) Sales by the partnership to the taxpayer, or any member of the taxpayer's combined reporting group, not to exceed the taxpayer's interest in all partnership sales.

(f)(3)(B) Notwithstanding any intercompany eliminations described in subparagraph (A) above, sales made to nonpartners, other than members of the partner taxpayer's combined reporting group, shall be included in the denominator of the taxpayer's sales factor in an amount equal to such taxpayer's interest in the partnership.

(g) When the activities of the partnership and the taxpayer do not constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be treated as a separate trade or business of the taxpayer.

Cal. Code Regs. tit. 18, § 17951-4(d)

If a nonresident is a partner in a partnership which carries on a unitary business, trade or profession within and without this state, the source of the partner's distributive share of partnership income derived from sources within this state shall be determined in the manner described below.

(1) Except as provided, the total business income of the partnership shall be apportioned at the partnership level in accordance with the apportionment rules of the Uniform Division of Income for Tax Purposes Act, Sections 25120 to 25139, Revenue and Taxation Code, and the regulations thereunder. Each partner's distributive share of the partnership business income apportioned to this state is income derived from sources within this state.
(2) If the partnership and the business activity of the partner are part of one unitary business, then the rules of Title 18, Cal. Code Regs., § 25137-1(f) apply and the apportionment of the partnership business income is done at the partner level for the unitary partner or partners. Each partner's distributive share of the partnership business income apportioned to this state is income derived from sources within this state.
(3) The source of guaranteed payments received by a nonresident partner from a partnership shall be determined as if the guaranteed payments were a distributive share of partnership business income.
(4) The source of a partner's distributive share of items which do not constitute business income shall be determined in accordance with the sourcing rules of Sections 17951 through 17955, Revenue and Taxation Code, and the regulations thereunder, as if the income producing activity were undertaken by the partner in its individual capacity.
(5) Except as provided in subsection (d)(6), the business activity of a partnership will not ordinarily be considered part of a unitary business with another business activity of one or more of its partners. However, if necessary to properly reflect the income or loss of the partnership or its partners, the Franchise Tax Board shall have the discretion to treat the business activity of a partnership and a business activity of one or more of its partners as part of a single unitary business, but only after conducting a comparable uncontrolled price examination in the manner provided by Section 23801(d)(1), Revenue and Taxation Code. For this purpose, the term "business activity" includes the partner's interest in the business activity of a sole proprietorship, another partnership, a limited liability company and an S corporation. If the Franchise Tax Board determines that unitary combination is appropriate under this subsection, the business income of the unitary activity shall be apportioned in accordance with the rules prescribed under subsection (d)(6)(A), without regard to the 20 percent limitation described therein.

(6) Exception for 20 percent or more interests. Subsection (d)(5) shall not apply to partners who own, directly or indirectly, a 20 percent or more capital or profits interest in a partnership. For purposes of this section, the ownership of a capital or profits interest in a partnership shall be determined under the rules of subsection (d)(6)(B).

(A) If a partner owns a 20 percent or more interest, as described in subsection (d)(6), and the business activity of the partnership is unitary with another business activity of the partner as that phrase is described in subsection (d)(5), the income of the unitary activity shall be combined at the partner level and apportioned to this state under the provisions of the Uniform Division of Income for Tax Purposes Act, Sections 25120- 25139 inclusive, Revenue and Taxation Code, and the regulations thereunder. In determining the amount of business income apportioned to this state, the partner shall combine the business income from unitary sole proprietorships and its distributive or pro rata shares of business income from 20 percent or more interests in unitary partnerships and S corporations. For purposes of the preceding sentence, the combined business income of a unitary partnership or S corporation shall be limited to the distributive or pro rata share of business income of the partner or shareholder from interests actually (not constructively) owned. The combined unitary business income shall be apportioned to this state under the provisions of the Uniform Division of Income for Tax Purposes Act, Sections 25120-25139, Revenue and Taxation Code, and the regulations thereunder, at the partner level. For that purpose, the partner shall aggregate its payroll, property and sales from unitary sole proprietorships and its proportionate share of payroll, property, and sales, whichever is applicable, from unitary partnerships and S corporations in which the partner or shareholder owns a 20 percent or more interest to arrive at a single apportionment percentage. That percentage is applied to the combined unitary business income computed under this subsection to determine the partner's business income from sources within this state.

(B) For purposes of this subsection (d)(6), the actual or constructive ownership of a capital or profits interest in a partnership shall be determined in accordance with the following rules:

1. An interest in partnership capital or profits which is owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries.

2. An individual shall be considered as owning the interest in partnership capital or profits owned, directly or indirectly, by or for his or her family.

3. The family of an individual shall include only his or her brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants, and

4. An interest in partnership capital or profits constructively owned by a person by reason of the application of subsection (d)(6)(B)1. shall, for the purpose of applying subsections (d)(6)(B)1. or (d)(6)(B)2., be treated as actually owned by such person, but an interest in partnership capital or profits constructively owned by an individual by reason of the application of subsection (d)(6)(B)2. shall not be treated as owned by him for the purpose of again applying either of such subsections in order to make another the constructive owner of such interest in partnership capital or profits.

EXAMPLE: Individual X is engaged in a sole proprietorship with business income of $100,000. In addition, X directly owns a 15% capital interest in Partnership P. X's sister Y also owns a 10% capital interest in P. X's distributive share of business income from P is $30,000, and his sister's distributive share of business income

> from P is $20,000. P and X's sole proprietorship are engaged in a unitary business. Under subsection (d)(6)(B), X is treated as constructively owning Y's interest in the partnership. Thus X's aggregate owned or constructively owned interest in P is 25%. Accordingly, X is subject to the apportionment provisions of subsection (d)(6)(A). However, under subsection (d)(6)(A), X will combine and apportion only the sum of his $100,000 proprietorship income and his actual distributive share of business income of $30,000 from P. The 20 percent test used to determine the applicability of subsection (d)(6) does not affect the amount of partnership income taken into account in computing income actually derived from sources within this state.

Appeal of Smith, California Office of Tax Appeals Decision No. 20036033 (Dec. 7, 2022)

> Applies Cal. Code Regs. tit. 18, § 25137-1 to a tiered partnership. The partnership's apportionment factors flowed through to the pass-through holding company partner.

Matter of J. Blau, California Office of Tax Appeals Decision No. 21088383 (July 7, 2023, *rehearing denied* May 9, 2024) *S*

> Involves the use of blended apportionment in a tiered partnership. "Appellant contends that the 'TRC LP apportionment factor should flow[-]through to [appellant]'; therefore, FTB should use the California apportionment percentage of 9.2511 from TRC LP, as modified by appellant, to source the 1231 net gain business income. However, appellant has not provided any details as to the composition of the apportionment factors for Yukon and TRC LP. Also, appellant did not explain the discrepancy between the California apportionment percentages originally reported by Yukon, 10.0640 percent, and TRC LP, 12.1215 percent. In sum, appellant fails to show potentially relevant facts of how income and apportionment factors should flow-through from the various underlying pass-through entities to TRC LP and from TRC LP to Yukon. For example, appellant did not establish whether some or all of the underlying pass-through entities (where the various 1231 net gain transactions originated) were unitary with TRC LP and whether Yukon was unitary with TRC LP. As such, appellant has not shown the 1231 net gain (generated by the various underlying pass-through entities) is properly apportioned using TRC LP's apportionment factors (modified to include the 1231 net gain transactions generated by the various underlying pass-through entities) without regard to Yukon's apportionment factors. (See Cal. Code Regs., tit. 18, § 25137-1(f) and (g).) Therefore, appellant has not established any basis to rebut FTB's determination which used the reported California apportionment percentage from Yukon to source the 1231 net gain business income to California."

California FTB Legal Ruling No. 2021-01

> Analyzes whether pass-through entity holding companies are unitary with other pass-through entities in various situations.
>
> "Lastly, one must not forget that, as discussed above, traditional tests for unity are not an exact fit in the context of pass-through entity holding companies. The traditional unitary tests were concerned with the extent to which the income and factors of disparate corporate affiliates could be combined and used to apportion income. In the corporate context, all factors and income of unitary entities are combined. However, with pass-through interests, an entity is unitary only to the extent of its interest in the pass-through entity. Therefore if a partner is unitary with a partnership and holds a 25 interest, the partner and 25 percent of the partnerships income and factors are combined. Thus, since not all of the income and factors of a unitary holding company are includable, attributes normally considered insignificant become critical. Therefore, in instances where a pass-through entity holding company holds less than a controlling interest in an operating entity, the holding company can still be unitary with the operating entity, to the extent of its ownership interest in the entity. This is because pass-

> through entities need not hold more than fifty percent of an entity to be unitary with that entity. As long as unitary indicia, as discussed above, exist, a pass-through entity holding company can be unitary with an operating entity. If a pass-through entity holding company provides value and support to the operating business, it will be properly treated as unitary with that business."

Matter of the Appeal of: JOHN E. FRANTZ, California State Board of Equalization Decision No. 461562 (May 30, 2012) (finding substantial economic effect for an allocation of losses).

California Form 565 Instructions (2023)

> For section 704(c) property use the California tax basis to determine section 704(c) built-in gain or loss.

Colorado

Colo. Rev. Stat. § 39-22-203(1)(a)

> In determining Colorado nonresident federal taxable income of a nonresident partner of any partnership, there shall be included only the portion of such partner's distributive share of items of partnership income, gain, loss, deduction, or credit derived from sources within Colorado determined in accordance with the provisions of section 39-22-109 or, at the partnership's election, apportioned or allocated to this state pursuant to section 39-22-303.5, 39-22-303.6, or 39-22-303.7.

Colo. Code Regs. § 39-22-109(3)(c)

> Distributive Share of a Member of a Pass-Through Entity. Income received as part of the Nonresident individual's distributive share of a Pass-through entity income, gain, loss, or deduction is Colorado-source income to the extent that the Pass-through entity determines that income is Colorado-source income pursuant to § 39-22-203(1)(a), C.R.S., and the rules promulgated thereunder. These rules apply to all Members of a Pass-through entity regardless of the type of the entity (e.g., limited liability company, limited liability partnership, limited liability limited partnership) or the status of the Member (e.g., limited or general).
>
> (i) A Nonresident has Nexus with Colorado if the Nonresident is a Member of a Pass-through entity doing business in Colorado.
>
> (ii) Character of Income. The activities of a Pass-through entity are attributable to its Members. Therefore, a Member is engaged in a Business in Colorado to the extent the Pass-through entity is engaged in Business in Colorado. The character of the item of income, loss, deduction or credit included in the Member's distributive share is determined as if the item was realized or incurred directly by the Member from the source from which the item was realized by the Pass-through entity or incurred in the same manner as the Pass-through entity. The principles of this paragraph apply in the case of an ownership chain that runs through multiple Pass-through entities.
>
> (iii) A Nonresident Member of a Pass-through entity deriving income from within Colorado and elsewhere has Colorado-source income as determined by § 39-22-109, C.R.S., and this rule, or as determined by § 39-22-303.6, C.R.S., and the rules thereunder if the Pass-through entity elects under § 39-22-203(1)(a), C.R.S., to apportion its income pursuant to § 39-22-303.6, C.R.S.
>
> (iv) A Nonresident Member's share of Colorado-source Business income of a Pass-through entity that elects to apportion its income pursuant to § 39-22-303.6, C.R.S.

(including the special apportionment rules adopted thereunder), shall be based on the Member's pro rata share of such Pass-through entity's income multiplied by the Pass-through entity's apportionment percentage.

(v) In the case of a Nonresident who is a Member of a partnership ("first partnership"), which partnership is a partner in another partnership ("second partnership"), the following rules apply:

(A) Unitary Partnerships. In the case of unitary partnerships, the election made by the second partnership is irrelevant to the treatment of income of the first partnership.

(I) If the first partnership makes the election to apportion its income pursuant to § 39-22-303.6, C.R.S. (including the special apportionment rules adopted thereunder), and is unitary with the second partnership as determined by general unitary theory, then the Nonresident member of the first partnership's share of Colorado source income is the Member's pro rata share of the partnership's Colorado-source income as determined by § 39-22-303.6, C.R.S. The first and second partnerships are treated as a single entity for purposes of calculating apportionment under § 39-22-303.6, C.R.S.

(II) If the first partnership makes the election not to apportion its income pursuant to § 39-22-303.6, C.R.S., and is unitary with the second partnership, then the partnerships are treated as one partnership and the income is sourced in accordance with this rule.

(B) Non-Unitary Partnerships. In the case of non-unitary partnerships, the election made by the first partnership is irrelevant to the treatment of income of the second partnership.

(I) If the two partnerships are non-unitary, then regardless of the election made by the first partnership, the first partnership's pro-rata share of the second partnership's Colorado-source income is directly allocated by the first partnership to Colorado and is not apportioned. The pro-rata share of such income passes through to the Nonresident Member as Colorado-source income.

(vi) A Nonresident individual may include as a credit for taxes paid on their Nonresident individual income tax return any payment made on their behalf by a partnership or Subchapter S corporation on a composite return. See §§ 39-22-601 (2.5) and (5), C.R.S. . . .

Connecticut

Conn. Gen. Stat. § 12-218(g)

(1) Any company that is (A) a limited partner in a partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) not otherwise carrying on or doing business in this state shall pay the tax imposed under section 12-214 solely on its distributive share as a partner of the income or loss of such partnership to the extent such income or loss is derived from or connected with sources within this state, except that, if the commissioner determines that the company and the partnership are, in substance, parts of a unitary business engaged in a single business enterprise or if the company is a member of a combined group that files a combined unitary tax return, the company shall be taxed in accordance with the provisions of subdivision (3) of this subsection and not in accordance with the provisions of this subdivision, provided, in lieu of the payment of tax based solely on its distributive share, such company may elect for any particular income year, on or before the due date or, if applicable the extended due date, of its corporation business tax return for such income year,

to apportion its net income within and without the state under the provisions of this chapter.

(2) Any company that is (A) a limited partner (i) in an investment partnership or (ii) in a limited partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) otherwise carrying on or doing business in this state shall apportion its net income, including its distributive share as a partner of such partnership income or loss, within and without the state under the provisions of this chapter, except that the numerator and the denominator of its apportionment fraction shall include its proportionate part, as a partner, of the numerator and the denominator of such partnership's apportionment fraction. For purposes of this section, such partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment fraction as if it were a company taxable both within and without this state.

(3) Any company that is a general partner in a partnership that does business, owns or leases property or maintains an office within this state shall, whether or not it is otherwise carrying on or doing business in this state, apportion its net income, including its distributive share as a partner of such partnership income or loss, within and without the state under the provisions of this chapter, except that the numerator and the denominator of its apportionment fraction shall include its proportionate part, as a partner, of the numerator and the denominator of such partnership's apportionment fraction. For purposes of this section, such partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment fraction as if it were a company taxable both within and without this state.

Conn. Gen. Stat. § 12-219a

(b)(1) Any company that is (A) a limited partner in a partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) not otherwise carrying on or doing business in this state shall apportion the average value of its partnership interest within and without this state under the provisions of subsection (a) of this section, except that the numerator and the denominator of its apportionment fraction shall be its proportionate part of the partnership's apportionment factors. For purposes of this section, the partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment factors as if it were a company taxable both within and without this state. However, if the commissioner determines that the company and the partnership are, in substance, parts of a unitary business engaged in a single business enterprise, or, if the company is a member of a combined group that files a combined unitary tax return, the company shall be taxed in accordance with the provisions of subdivision (3) of this subsection and not in accordance with the provisions of this subdivision.

(b)(2)Any company that is (A) a limited partner (i) in an investment partnership or (ii) in a limited partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) otherwise carrying on or doing business in this state shall apportion its additional tax base, including the average value of its partnership interest, within and without the state under the provisions of subsection (a) of this section, except that the numerator and the denominator of its apportionment factors shall include its proportionate part of the numerator and the denominator of the partnership's apportionment factors. For purposes of this section, the partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment factors, as if it were a company taxable both within and without this state.

(b)(3) Any company that is a general partner in a partnership that does business, owns or leases property or maintains an office within this state shall, whether or not it is

otherwise carrying on or doing business in this state, apportion its additional tax base, including the average value of its partnership interest, within and without the state under the provisions of subsection (a) of this section, except that the numerator and the denominator of its apportionment factors shall include its proportionate part of the numerator and the denominator of the partnership's apportionment factors. For purposes of this section, the partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment factors, as if it were a company taxable both within and without this state.

(d)The additional tax base of taxable and nontaxable members of a combined group required to file a combined unitary tax return pursuant to section 12-222 shall be apportioned as provided in subsection (g) of section 12-218e.

Conn. Gen. Stat. § 12-213(a)(32)

(32) "Unitary business" means a single economic enterprise that is made up either of separate parts of a single business entity or of a group of business entities under common ownership, which enterprise is sufficiently interdependent, integrated or interrelated through its activities so as to provide mutual benefit and produce a significant sharing or exchange of value among such entities, or a significant flow of value among the separate parts. For purposes of this chapter, (A) any business conducted by a pass-through entity shall be treated as conducted by its members, whether directly held or indirectly held through a series of pass-through entities, to the extent of the member's distributive share of the pass-through entity's income, regardless of the percentage of the member's ownership interest or its distributive or any other share of pass-through entity income, and (B) any business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a pass-through entity if there is a mutual benefit and a significant sharing of exchange or flow of value between the two parts of the business and the two corporations are members of the same group of business entities under common ownership.

Conn. Agencies Regs. § 12-715(a)-1

(c) The amount of any modification to be made by a partner with respect to a partnership item of income, gain, loss or deduction is to be determined as follows:

(1) If a modification relates to any item subject to special allocation among the partners under the partnership agreement, which item is therefore accounted for separately for federal income tax purposes, the amount of each partner's share of the modification is determined by such partner's distributive share of such item for federal income tax purposes.
(2) If a modification relates to an item that is included in computing the partnership's taxable income or loss generally (i.e., that portion of federal adjusted gross income described in section 702(a)(8) of the Internal Revenue Code), other than an item subject to a special allocation among the partners under the partnership agreement that differs from the allocation of partnership taxable income or loss generally, each partner's modification relating to that item is determined by such partner's distributive share for federal income tax purposes of the taxable income or loss of the partnership required to be reported in accordance with said section 702(a)(8).
(3) If a modification relates to an item that is not taken into account for federal income tax purposes (such as interest income on bonds of other states) and such item is not one which is subject to a special allocation among the partners under the partnership agreement that differs from the allocation of partnership taxable income or loss generally, each partner's modification in respect to such an item is determined by such partner's distributive share for federal income tax purposes of the

taxable income or loss of the partnership described in section 702(a)(8) of the Internal Revenue Code.

(4) If a modification relates to an item that is not taken into account for federal income tax purposes (such as interest income on bonds of other states) and such item is one which is subject to a special allocation among the partners under the partnership agreement that differs from the allocation of partnership taxable income or loss generally, each partner's modification in respect to such an item is determined by the allocation provided for in the partnership agreement.

(d) The modifications covered by this section do not apply to any item attributable to the partner directly and not reflected on the Connecticut partnership informational return (Form CT-1065), such as a gain that the partner realizes on the sale of the partnership interest.

Conn. Agencies Regs. § 12-715(c)-1

(a) If a partnership agreement provides for a special allocation among the partners of any item of partnership income, gain, loss or deduction, federal income tax law requires that such a provision be disregarded for federal income tax purposes, where its principal purpose is the avoidance or evasion of federal income tax. In such a case, each partner's distributive share of such item is determined by such partner's distributive share for federal income tax purposes of the taxable income or loss of the partnership as described in section 702(a)(8) of the Internal revenue Code. This treatment and distribution of the item is reflected in each partner's federal adjusted gross income and, therefore, in each partner's Connecticut adjusted gross income, even though in a particular case no Connecticut income tax avoidance or evasion may be involved.

(b) In certain cases, however, a provision for special allocation does not have as its principal purpose the avoidance or evasion of federal income tax, but has as its principal purpose the avoidance or evasion of Connecticut income tax. In such an instance, any such provision shall be disregarded and each partner's share of the pertinent item of partnership income, gain, loss or deduction shall also be determined by the partner's distributive share for federal income tax purposes of the taxable income or loss of the partnership as described in section 702(a)(8) of the Internal Revenue Code.

(c) Whether the principal purpose of a special allocation of an item is the avoidance or evasion of Connecticut income tax depends on the surrounding facts and circumstances. Among the relevant facts to be considered are the following: whether the partnership or partner individually has a business purpose for the allocation; whether the allocation has substantial economic effect, as the term is used in section 704(b)(2) of the Internal Revenue Code (i.e., whether the allocation may actually affect the dollar amount of the partners' shares of the total partnership income or loss independently of Connecticut income tax consequences); whether related items of income, gain, loss or deduction from the same source are subject to the same allocation; whether the allocation was made without recognition of normal business factors and only after the amount of the specially allocated item could reasonably be estimated; the duration of the allocation; and the overall Connecticut income tax consequences of the allocation.

Example: A and B are equal partners. The partnership agreement, however, allocates to A, who has a higher effective rate of Connecticut income tax than B, all interest income on bonds of the State of Connecticut held by the partnership and allocates to B all interest income on bonds of other states. The partnership agreement also provides that any difference in the amounts of such interest income allocated to each partner is to be equalized out of other partnership income. Because the purpose and effect of this allocation is solely to reduce the Connecticut income tax of A without actually affecting the distributive shares of A and B in partnership income, such allocation is not recognized. Accordingly, in determining their

respective Connecticut adjusted gross incomes, A and B each shall add to federal adjusted gross income one-half of the interest income from bonds of other states under § 12-701(a)(20)-2 of Part I.

(d) While this section pertains to Section 12-715(c) of the general statutes, for purposes of supplementary interpretation, as the phrase is used in Section 12-2 of the general statutes, the adoption of this section is authorized by Section 12-740(a) of the general statutes.

Delaware

Del. Code Ann. tit. 30, § 1622

Each item of the income, gain, loss or deduction of a pass-through entity shall have the same character for a member of such pass-through entity under this title as it has for federal income tax purposes. Where federal income tax rules and principles are not determinative of the character or of the source of an item of income, gain, loss or deduction for purposes of this title, such item shall have the same character or source for a member of the pass-through entity as if the item were realized directly by such member from the source from which realized by the pass-through entity or incurred in the same manner as incurred by the pass-through entity. A member's distributive share of any item of the income, gain, loss or deduction of a pass-through entity shall, solely for purposes of the immediately preceding sentence, be determined by application of the principles of § 704(b) of the Internal Revenue Code [26 U.S.C. § 704(b)], including, without limitation, the principles for determining whether an allocation of such item among the members of such pass-through entity has substantial economic effect.

Del. Code Ann. tit. 30, § 1623

(c) Corporate members of pass-through entities. — A corporation that is a member of a pass-through entity doing business or having real or tangible personal property in this State shall be subject to the provisions of Chapter 19 of this title; provided, however, that this subsection shall not be interpreted as precluding a corporation that is a member of a pass-through entity from qualifying for exemption from taxation under Chapter 19 pursuant to § 1902(b)(8) of this title.

(d) Allocation and apportionment of income. — In determining the tax liability under Chapter 19 of this title of a corporation that is a member of a pass-through entity doing business or having real or tangible personal property in this State:

Such corporation's federal taxable income shall be increased or decreased, as the case may be, by its distributive share of such pass-through entity's items, if any, described in § 1903(a) of this title;

Such corporation's distributive share of any item of such pass-through entity that is described in any of § 1903(b)(1) through (5) of this title shall be included in the entire net income of such corporation only if such item is properly allocable to this State under such § 1903(b) of this title; and

In applying § 1903(b)(6) of this title to such corporation,

(1) The entire business of such corporation shall not be treated as having been transacted or conducted within this State if any part of the business of such pass-through entity was transacted or conducted outside this State; and

(2) The 3 ratios described in such § 1903(b)(6) of this title of such corporation shall be determined by including in each such ratio such corporation's distributive share of each relevant item of such pass-through entity.

In applying § 1903(b)(7) of this title to such corporation, the ratio described in such § 1903(b)(7) of this title of such corporation shall be determined by including in such ratio the corporation's distributive share of each relevant item of such pass-through entity.

District of Columbia

D.C. Code § 47-1801.4(55)(B)

For the purposes of this chapter, any business conducted by a partnership within the meaning of § 47-1808.06 shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the percentage of the partner's ownership interest or its distributive or any other share of partnership income. A business conducted directly or indirectly by one person is unitary with that portion of a business conducted by another person through its direct or indirect interest in a partnership if there is a synergy and exchange and flow of value between the 2 parts of the business and the 2 persons are members of the same commonly controlled group.

D.C. Code § 47-1810.02

Allocation and apportionment. - The entire net income of any corporation, financial institution, or unincorporated business, or the unrelated business income of an exempt organization, derived from any trade or business carried on or engaged wholly within the District shall, for the purposes of this chapter, be deemed to be from sources within the District and shall, along with other income from sources within the District, be allocated to the District. If the net income of a corporation, financial institution, or unincorporated business, or the unrelated business income of an exempt organization, is derived from sources within and without the District, the taxpayer shall apportion business income and allocate non-business income as provided in this section.

D.C. Code § 47-1810.04(c)(1)(B)(2)

If any member owns an interest in a partnership that is not an unincorporated business, as defined by § 47-1808.01, the income or loss of such partnership shall be apportioned to the District using the apportionment factor of the partnership, and the combined group member-partner's distributive share of such income shall be added to the combined group member-partner's income."

D.C. Mun. Regs. tit. 9, § 109.20(h)

The amounts of the property, payroll, and sales of a partnership are attributable to the partners or members of the joint venture. A corporation that is a partner in a partnership must add its share of the property, payroll, and sales to its own apportionment factors, regardless of whether the partnerships are District of Columbia partnerships. The affiliated group should include a separate schedule to show the distribution to each partner.

Agency Website

If a partner is a combined group member, the partner must include or exclude its distributive share of income or loss in the following manner:

(a) Starting point for a partner: A partner on the D-20 or D-30 generally starts with federal income and deduction items which are modified for District purposes. In this income, the distributive share of partnership interest should already have been included and modified for District tax purposes on the "Other income (loss)" line (currently line 9, on D-20 or D-30).

(b) Exclusion modification: If the distributive share has been reported by and taxed against any person, the partner's distributive share of this income or loss shall be excluded from the partner's return on line 9 of the D-20 or D-30 to prevent double taxation or double deduction (see also UB Worksheet A and B). The amount that should be excluded is that which has been apportioned to and taxed within the District and that portion which has been subject to apportionment and taxed outside the District.

(c) Treatment of distributive loss: If the distributive share of a partner is a loss and the entity which issued the distributive share is also filing a District return (stand-alone or combined), and the entity is carrying forward that loss to future years, the distributive share of that loss is not allowed on the partner's return to avoid double deduction of the loss because this loss is a loss of the entity and not of the partner.

(d) No flow through of factors: A partner shall not flow through its share of the UB or partnership's apportionment factors and combine them with its own factors. However, a single member entity, if disregarded for federal income tax purposes, shall be treated as disregarded for District income and franchise tax purposes, and all the income, deductions, and apportionment factors shall be included with and reported by the owner of the single member entity.

(e) Apportionment of partner's distributive share of UB or partnership: If the UB or partnership is both within and without the District, then any portion of the partner's distributive share from the K-1 (modified for District tax purposes) which has not been reported and taxed at the UB level on the combined report shall be included in the partner's income and apportioned, if it is business income.

(f) To calculate the apportionment factor to apply to the untaxed income as indicated in (e):

(1) Denominator. The denominator shall be the total net unreported and untaxed distributive share of the income which shall be added to the partner's sales factor.

(2) Numerator. The numerator shall be the unreported and untaxed portion of the distributive share multiplied by the UB's or partnership's apportionment percentage.

(3) Example: If the distributive share is $200 and $100 of that share was reported and taxed at the UB level, and the remaining $100 (the net amount) was untaxed, that $100 will be added to the partner's sales factor denominator. If the UB's apportionment factor is 50%, then $50 will be added to the partner's sales factor numerator for purposes of apportioning the part which was not previously apportioned and taxed

(g) UB filing requirements: If a UB is a member of the combined group, the UB shall report all its income and apportionment factors on the combined report only and not file a stand-alone return.

Florida

Fla. Admin. Code Ann. r. 12C-1.015(10)

Partnerships. The amounts of the property, payroll, and sales of a partnership are attributable to the partners or members of the joint venture. A corporation that is a

partner in a partnership must add its share of the property, payroll, and sales to its own apportionment factors, regardless of whether the partnerships are Florida partnerships. Form F-1065 is used in part to distribute to each partner subject to the tax its share of the apportionment factors of the partnership or joint venture.

Florida TAA # 11C1-001(February 2, 2011)

> Whether the taxpayer's sales, payroll, and property factors of the apportionment formula should include the taxpayer's interest in various partnerships . . .
>
> The Florida statutes and rules are clear that the activities of a partnership flow through the partnership to its partners. In its letter dated XXX, the taxpayer states that the partnerships it invests in contain multiple layers of ownership, and the lower tiered and middle tiered partnerships do not report apportionment information to the top tiered partnership because they are not required to do so in the states where they are located. Therefore, the upper tiered partnerships do not have any way to report the apportionment information from the middle and lower tiered partnerships to the corporate partner (in this case the taxpayer).
>
> For federal income tax purposes, partnerships generally have no formal federal filing requirement other than information returns, and because a partnership is a conduit, items of partnership income, expense, gain, or loss pass through to the partners and are given tax effect at the partner level. For state income tax apportionment purposes, a particular state's approach in this area dictates the flow-through of partnership tax attributes up to the corporate partner.
>
> Florida's approach conforms to the federal concept of the flow-through of partnership tax attributes up to the corporate partner. The apportionment rule, Rule 12C-1.015(10), F.A.C., governs the corporate income tax treatment of corporations that invest in partnerships. This rule provides that a corporation that is a partner in a partnership must add its share of the partnership's property, payroll, and sales to its own apportionment factor. Based on the foregoing, the partnerships' property, payroll, and sales should be combined with the taxpayer's property, payroll, and sales, for purposes of determining the taxpayer's apportionment factor as provided by Rule 12C-1.0153(9), F.A.C., Rule 12C-1.0154(6), F.A.C., and Rule 12C-1.0155(4), F.A.C.
>
> The taxpayer asserts that the tiered partnerships do not provide the taxpayer with their respective apportionment factors. Therefore, the taxpayer does not have the required apportionment information to correctly apportion its income in accordance with Rule 12C-1.015(10), F.A.C. However, the Florida statutes and rules are clear that the activities of a partnership flow through the partnership to its partners. Therefore, the activities of the partnership are attributable to the partners and, contrary to the statement in the taxpayer's letter, are unitary to the partners.

Florida TAA # 23C1-012 (October 3, 2023)

> In the case of a flow-through entity (i.e., whose income flows through to Taxpayer, Taxpayer's portion of the sales factor provided to it by _____ for inclusion in Taxpayer's own factors should reflect the proper sourcing of the _____ based on the location of _____customers.

Florida TAA # (November 10, 2014)

> While section 220.152, F.S., authorizes a taxpayer to petition the Department to use an alternative apportionment method if the methods of sections 220.15 and 220.151, F.S., do not fairly represent the taxpayer's tax base attributable to Florida, the taxpayer is also required to show that use of the apportionment method provided by section 220.15, F.S., causes its tax base attributable to Florida to be unfairly represented. Here,

> Florida law requires the taxpayer to include its share of the LLC's property, payroll, and sales, with its own, in computing its Florida apportionment factor. The taxpayer has not shown that using this apportionment method causes its tax base attributable to Florida to be unfairly represented. Therefore, the Department cannot approve an alternative apportionment method.
>
> CONCLUSION
>
> Based on the discussion above, Florida law requires the taxpayer to include its share of the LLC's property, payroll, and sales, when determining the taxpayer's apportionment factor. Additionally, as the taxpayer has failed to show that use of the apportionment method provided by section 220.15, F.S., causes its tax base attributable to Florida to be unreasonably and arbitrarily represented, the taxpayer is required to use the apportionment method provided by section 220.15, F.S., in apportioning its income to Florida.

Florida Form F-1065: Partnership Information Return Instructions (2022)

> Each partner's share of the apportionment factors is determined by multiplying the amount in Part III-A, on Lines 1, 2, and 3 by the percentage interest of each partner. Amounts determined should be added to each partner's apportionment factors included on its Florida Form F-1120. Partnerships subject to a special industry apportionment fraction (for example, those engaged mainly in transportation services) should adjust this schedule to report each partner's share of the special apportionment fraction (for example, revenue miles for transportation).

Georgia

Ga. Comp. R. & Regs. § 560-7-7-.03(4)(e) and 5(f)

> A corporation that is involved in a business joint venture, is a member of a limited liability company or similar nontaxable entity not treated as a corporation for federal income tax purposes, or is a partner in a business partnership, must include its pro rata share of the entity's property, payroll, and gross receipts in its own apportionment formula. In determining its income, the corporation includes its share of the entity's income before the entity apportions and allocates its income.

Ga. Code Ann. § 48-7-53(c)(3)(C) *(*in audit situation)

> Determine the total distributive share of all final federal adjustments and positive reallocation adjustments as modified by this title and apportion and allocate such adjustments as provided in Code Section 48-7-31 for such electing partnership or such electing tiered partner and determine the total distributive share of such amounts that are allocated to all corporate partners, all tiered partners, all exempt partners and that is unrelated business income, all nonresident individual partners, and all nonresident fiduciary partners. If the commissioner determines that a partnership or tiered partner fraudulently underreported its income on a return, the commissioner shall treat any income attributable to a tiered partner of such partnership or tiered partner as being apportioned and allocated entirely to Georgia to the extent the direct and indirect partners of such tiered partner are resident partners.

Hawaii

Haw. Code R. § 18-235-29-04

(a) If a taxpayer is a partner in a partnership, and the partnership's activities and the taxpayer's activities constitute a unitary business:

(1) The taxpayer's share of the partnership's trade or business shall be combined with the taxpayer's trade or business;

(2) The property, payroll, and sales factors, or other applicable factors, of the taxpayer and the partnership shall be combined; and

(3) Intercompany items shall be eliminated, under the principles set forth in section 18-235-22-03.

Example 1: Corporation A's distributive share of income in partnership P is 20 per cent. Corporation A manufactures toys which are sold in the seven western states by partnership P. Corporation A's business income for the year was $1,000,000 and partnership P's business income for the same year was $800,000. The business income of corporation A is $1,160,000 ($1,000,000 plus 20 per cent of $800,000).

Example 2: The facts are the same as in Example 1. Partnership P owns a building with an original cost of $100,000 which is rented to corporation A for $12,000 per year. Corporation A shall include $20,000 (20 per cent of $100,000) in its property factor because of its interest in partnership P. In addition, Corporation A shall take into account $9,600 ($12,000 less 20 per cent of $12,000) of rental expense into its property factor in order to include in the property factor the rented building used in Corporation A's operation. Thus, Corporation A shall include $76,800 ($9,600 multiplied by 8, pursuant to section 235-31, HRS) for the rent paid, and $20,000 for its interest in the building through Partnership P, in its property factor, totalling $96,800 attributable to the building.

(b) If a taxpayer is a partner in a partnership, and the partnership's activities and the taxpayer's activities do not constitute a unitary business, the partnership shall allocate and apportion its income at the partnership level. The taxpayer's distributive share of the partnership's income allocated or apportioned to this State shall not be subject to further apportionment by the taxpayer.

Example: Corporation A's distributive share of income in partnership P is 20 per cent. Corporation A manufactures and sells toys in the seven western states. Partnership P operates farms within and without this State. Both corporation A and partnership P earn exclusively business income, except for distributions from Partnership P. Corporation A's business income for the year is $1,000,000 and partnership P's income is $800,000 for the same year. Because corporation A and partnership P are engaged in two different trades or businesses, corporation A shall apportion its $1,000,000 income on the basis of its own apportionment formula. Partnership P shall apportion its business income of $800,000 on the basis of its own apportionment formula. Corporation A's apportionment factors are determined without regard to Partnership P's apportionment factors, and vice versa. Assume that corporation A's apportionment percentage determined under section 18-235-29-01 is 35 per cent, and that partnership P's apportionment percentage is 10 per cent. Partnership P's Hawaii income is 10 per cent of the income from its farming business ($80,000 = 10 per cent × $800,000). Corporation A is taxable in this State upon 35 per cent of the income from its toy manufacturing business ($350,000 = 35 per cent × $1,000,000) plus its full distributive share of the partnership income attributed to this State ($16,000 = 20 per cent × $80,000), or $366,000.

Idaho

Idaho Admin. Code r. 35.01.01.620

01. In General. If a corporation required to file an Idaho income tax return is a member of an operating partnership, the corporation is to report its Idaho taxable income, including its share of income from the partnership, in accordance with this rule. For purposes of this rule, the term partnership includes a joint venture.

02. Transacting Business. A corporation is transacting business in Idaho if it is a partner in a partnership that is transacting business in Idaho even though the corporation has no other contact with Idaho. In this case, both the partnership and the corporation have an Idaho filing requirement.

03. Multistate Partnerships. If a partnership operates in more than one state, its income is to be apportioned and allocated on the partnership return as if the partnership were a corporation. The allocation and apportionment rules of Section 63-3027, Idaho Code, and related rules apply to the partnership.

04. Partnership Income as Apportionable Income of the Partner.

a. Income. If the income or loss of a partnership is apportionable income or loss to a corporate partner, its share of this net apportionable income or loss is to be apportioned together with all other net apportionable income or loss of the corporation. Apportionable income or loss is defined by Section 63-3027(1)(a), Idaho Code, and Rules 330 through 336 of these rules.

b. Factors. A corporate partner's share of the partnership property, payroll, and sales after intercompany eliminations, is to be included in the numerators and the denominators of the partner's property, payroll, and sales factors when computing its apportionment formula. The partner's share of the partnership's property, payroll, and sales is determined by attributing the partnership's property, payroll, and sales to the partner in the same proportion as its distributive share of partnership income if reporting net income for the taxable year or in the same proportion as its distributive share of partnership losses if reporting a net loss for the taxable year. Generally, the partnership's property, payroll, and sales includable in the corporation's factor computations is determined in accordance with Section 63-3027, Idaho Code, and related rules. To determine how the sales attribution rules of Sections 63-3027(12) and (13), Idaho Code, apply to the sales factor of the corporate partner, the sales of the partnership are treated as if they were sales of the corporation.

05. Partnership Income as Nonapportionable Income of Partner.

a. Income. If the partnership income or loss is not apportionable income to a corporate partner, the income is nonapportionable income as defined in Section 63-3027(1)(h), Idaho Code, and Rules 335 through 339 of these rules. The corporate partner is to allocate the nonapportionable income to the state in which it was earned. The corporate partner, on its Idaho corporation income tax return, is to specifically allocate to Idaho its share of the nonapportionable income attributable to Idaho.

b. Factors. If the partnership income or loss is nonapportionable income to the corporate partner, none of the partnership property, payroll, or sales may be included in the computation of the factors of the corporation.

Idaho Admin. Code r. 35.01.01.785(01)(d) (01/01/2006)

Idaho credits may not pass through to partners or owners based on special allocations.

Illinois

35 Ill. Comp. Stat. 5/305

(a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

(b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

(c) Allocation or apportionment of base income by partnership. Base income of a partnership shall be allocated or apportioned to this State pursuant to Article 3, in the same manner as it is allocated or apportioned for any other nonresident . . .

Ill. Admin. Code tit. 86, § 100.3500(d)

Allocation and Apportionment of Base Income by Nonresident Partners

a) In General.

1) This Section provides guidance for allocation and apportionment of base income by nonresidents. All base income of a resident is allocated to Illinois pursuant to IITA Section 301(a) . . .

3) Unitary partners. This Section shall not apply to the apportionment of business income of a nonresident partner who is engaged in a unitary business with the partnership. Such partners shall apportion their unitary business income derived from the partnership in accordance with IITA Section 304(e) and Section 100.3380(d) of this Part.

4) Except as provided in this subsection (a), all items of base income of a partner that are derived from the partnership shall be allocated or apportioned pursuant to this Section, including all items required to be separately stated to the partner under IRC section 703(a)(1), all guaranteed payments under IRC section 707(c), and all addition and subtraction modifications, but excluding items described in IRC section 707(a).

b) Business Income. The respective shares of partners other than residents in so much of the business income of the partnership as is apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State. (IITA Section 305(a))

1) For purposes of this subsection (b), the determination of whether an item of base income is business income or nonbusiness income shall be based on the facts and circumstances of the partnership itself. Trade or business activities of a partner or of any related party are irrelevant.

2) Business income of the partnership shall be apportioned to this State pursuant to IITA Section 304, in the same manner as it is allocated or apportioned for any other nonresident. (IITA Section 305(c))

3) Lower-tier partnerships. In the case of a partnership that is itself a partner in a second partnership, a partner in the first partnership shall include in net income its partnership share of the first partnership's share of the items of business income of the second partnership, as apportioned to Illinois by that second partnership. If the second partnership is itself a partner in a third partnership, a partner in the first partnership shall include in net income its partnership share of the first partnership's share of the items of business income of the third partnership as determined under the preceding sentence, and so on through all partnerships that are themselves partners in other partnerships.

c) Nonbusiness Income. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities. (IITA Section 305(b))

Ill. Admin. Code tit. 86, § 100.3380(d)

Unitary Partners: Inclusion of Shares of Partnership Unitary Business Income and Factors in Combined Unitary Business Income and Factors of Partners

1) IITA Section 304(e) provides that whenever 2 or more persons are engaged in a unitary business as described in IITA Section 1501(a)(27), a part of which is conducted in this State by one or more members of the group, the business income attributable to this State by any member or members shall be apportioned by means of the combined apportionment method. Because partnerships may be members of a unitary business group within the meaning of IITA Section 1501(a)(27), this provision requires a partnership to use combined apportionment when it is engaged in a unitary business with one or more of its partners. However, partners who are not engaged in a unitary business with the partnership shall include their shares of the partnership's business income apportioned to Illinois in their Illinois net incomes under IITA Section 305(a), and those partners' business activities or share of the partnership's market in Illinois would not be represented fairly by their shares of partnership income computed by combining the business income and apportionment factors of the partnership with the business income and apportionment factors of its unitary partners.

2) Accordingly, except in a case in which substantially all of the interests in the partnership (other than a publicly-traded partnership under IRC section 7704) are owned or controlled by members of the same unitary business group, when the business activities of a partnership and any of its partners' business activities constitute a unitary business:

A) The partner's distributive share of the business income and apportionment factors of the partnership shall be included in that partner's business income and apportionment factors. Also, for taxable years ending on or after December 31, 2017, the partner's distributive share of the everywhere sales of the partnership shall be included in the partner's everywhere sales for purposes of applying Section 100.3600. In determining the business income of the partnership, transactions between the unitary partner (or members of its unitary business group) and the partnership shall not be eliminated. However, all transactions between the unitary business group and the partnership shall be eliminated for purposes of computing the apportionment factors of the partner and of any other member of the unitary business group.

EXAMPLE: Partner and Partnership are engaged in a unitary business. Partner owns a 20% interest in Partnership. Partnership has $10,000,000 in sales everywhere, $3,000,000 of which are to Partner, and $4,000,000 in Illinois sales, $1,000,000 of which are to Partner. In computing its apportionment factor, Partner shall include $1,400,000 from Partnership in its everywhere sales (20% of Partnership's $10,000,000 in everywhere sales, after eliminating the $3,000,000 in sales to Partner) and $600,000 from Partnership in its Illinois sales (20% of Partnership's $4,000,000 in Illinois sales, after eliminating the $1,000,000 in sales to Partner). Also, Partner must eliminate any sales it made to Partnership.

B) If a partnership and one of its partners are engaged in a unitary business and the partnership is itself a partner in a second partnership:

i) If the partner is not engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall not be included in the partner's business income and apportionment factors. Instead, the partner's share of the first partnership's share of the base income apportioned to Illinois by the second partnership shall be included in the partner's Illinois net income.

ii) If the partner is engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall be included in the partner's business income and apportionment factors.

C) If, for taxable years ending on or after December 31, 2017, a partner and a partnership engaged in a unitary business apportion their business income using different apportionment formulas under IITA Section 304:

i) The apportionment percentage of the partnership shall computed under Section 100.3600 by treating the partnership as a member of the unitary business group, but using only that partner's distributive share of the partnership's apportionment factors and sales. That partner's apportionment percentage is equal to that partner's apportionment percentage computed under Section 100.3600 plus the partnership's apportionment percentage computed under Section 100.3600.

ii) If a partnership has more than one partner in the same unitary business group, and the partnership uses a different apportionment formula than one or more of the partners, each partner that uses the same apportionment formula as the partnership shall compute its apportionment factor as provided in subsection (d)(2)(A) and each partner that uses a different apportionment formula shall compute its apportionment factor as provided in subsection (d)(2)(C)(i).

3) This subsection (d) does not apply to a partner's shares of business income and apportionment factors from any partnership that cannot be included in a unitary business group with that partner.

A) This subsection (d) does not apply because:

i) for taxable years ending prior to December 31, 2017, the partner and the partnership are required to apportion their business income using different apportionment formulas under IITA Section 304, and therefore cannot be members of a unitary business group under IITA Section 1501(a)(27); or

ii) the business activities of either the partner or the partnership outside the United States are equal to or greater than 80% of the total worldwide business activities of that partner or partnership, as determined under IITA Section 1502(a)(27). In applying this 80/20 test to a taxpayer, no apportionment factors of any partnership shall be included in the apportionment factors of that taxpayer pursuant to this subsection (d).

B) For taxable years ending prior to December 31, 2017, if the partnership is itself a partner in a second partnership, and one of its partners is engaged in a unitary business with the second partnership and is not prohibited from being a member of a unitary business group that includes the second partnership under subsection (d)(3)(A)(i) or (ii), that partner shall include in its business income and apportionment factors its share of the partnership's share of the second partnership's business income and apportionment factors.

4) If substantially all of the interests in a partnership (other than a publicly-traded partnership under IRC section 7704) are owned or controlled by members of the same unitary business group as the partnership, the partnership shall be treated as a member of the unitary business group for all purposes, and, for purposes of applying IITA Section 305(a) to any nonresident partner who is not a member of the same unitary business group, the business income of the partnership apportioned to this State shall be determined using the combined apportionment method prescribed by IITA Section 304(e). For purposes of this subsection (d), substantially all of the interests in a partnership are owned or controlled by members of the same unitary business group if more than 90% of the federal taxable income of the partnership is allocable to one or more of the following persons:

A) any member of the unitary business group;

B) any person who would be a member of the unitary business group if not for the fact that 80% or more of that person's business activities are conducted outside the United States;

C) any person who would be a member of the unitary business group except for the fact that the person and the partnership apportion their business incomes under different subsections of IITA Section 304 and, therefore, for taxable years ending prior to December 31, 2017, would be excluded from a unitary business group in which the partnership is a member; or

D) any person who would be disallowed a deduction for losses by IRC section 267(b), (c) and (f)(1) by virtue of being related to any person described in subsection (d)(4)(A), (B) or (C), as well as any partnership in which a person described in subsection (d)(4)(A), (B) or (C) is a partner.

5) Examples

EXAMPLE 1: Corporation A owns a 50% interest in P-1, a partnership. Corporation A and P-1 are engaged in a unitary business within the meaning of IITA Section 1501(a)(27). P-1 itself conducts no business activities in Illinois, and the Illinois numerator of its apportionment factor is zero. P-1 holds a 50% interest in P-2, a partnership doing business exclusively in Illinois. P-1 has $1.4 million of taxable business income, not including any income from P-2. P-2 has base income of $1 million, all of which is business income, and on a separate-entity basis, all of its business income would be apportioned to Illinois.

EXAMPLE 2: If Corporation A and P-2 are not members of the same unitary business group, Corporation A would compute its business income apportioned to Illinois by including $700,000 (50% of $1.4 million) of P-1's business income in Corporation A's business income, and 50% of P-1's apportionment factors in its apportionment factors. Corporation A also would include in its Illinois net income its 50% share of P-1's 50% share of the base of P-2 apportionable to Illinois, or $250,000 (50% of 50% of $1 million).

EXAMPLE 3: If Corporation A, P-1 and P-2 are members of the same unitary business group, P-1 shall include 50% of P-2's business income and 50% of P-2's apportionment factors in its own business income and apportionment factors. Accordingly, P-1's

business income will be $1.9 million (the $1.4 million it earned directly plus its 50% share of P-2's $1 million in business income). Corporation A will then compute its business income apportioned to Illinois by including its 50% share of P-1's business income, or $950,000 (50% of $1.9 million) with its business income and its 50% share of P-1's apportionment factors (which will include P-1's share of P-2's apportionment factors) in its apportionment factors.

EXAMPLE 4: If Corporation A, P-1 and P-2 are unitary, but P-1 is excluded from the unitary business group of Corporation A and P-2 because those entities apportion their business income under IITA Section 304(a) and P-1 is a financial organization that apportions its business income under IITA Section 304(c) and the taxable year ends prior to December 31, 2017, Corporation A shall include in its business income and apportionment factors its 50% share of P-1's 50% share of the business income and apportionment factors of P-2. Also, Corporation A's Illinois net income includes 50% of the business income of P-1 apportioned to Illinois by P-1 using its own apportionment factors. Because, in this example, P-1 is not doing business in Illinois, none of its business income is included in Corporation A's Illinois net income . . .

IT 24-0002-GIL (03/18/2024) (denial of a partnership's request for alternative apportionment)

Because your request merely states that separate accounting for the taxpayer's Illinois income more accurately reflects its Illinois activity, your petition for alternative apportionment does not meet the regulatory requirement and cannot be granted at this time.

IT 93-0107-PLR (05/11/1993)

The above-named partnership is filing this petition to seek permission from the Department of Revenue to use an alternative apportionment method as allowed under IITA Section 304(f). The partnership believes that the allocation and apportionment provisions of IITA Section 304(a) through (d) do not fairly represent the partnership's business activity in Illinois.

The partnership believes the use of the standard formulary apportionment will significantly distort its income or loss from its activities in this state. Since this partnership's business activity is the ownership and management of rental real property located in various states, this partnership believes that a separate reporting of income or loss to each state based on the rental activity occurring in the state is the most equitable method for reporting corporate income . . .

We have reviewed your letter and are unable to conclude that you have met the burden of demonstrating that the three factor formula operates unreasonably and arbitrarily in attributing to Illinois a percentage of income that is out of all proportion to the business transacted in this State.

Rockwood Holding Co. v. Department of Revenue, 728 N.E.2d 519 (App. 1st Dist. 2000) (denying alternative apportionment in connection with a partnership loss deduction).

The plain language of section 304(f) seeks to achieve a fair representation of "the extent of a person's business activity" in Illinois. It does not address the calculation of the taxpayer's tax liability.

Illinois IL-1065 Instructions(2022)

Partnerships may not join in the filing of a combined return. However, you may be required to file a separate unitary return, and file a Schedule UB, Combined Apportionment for Unitary Business Group, to apportion your business income. If the following

applies, do not file a Schedule UB: If a partnership is engaged in a unitary business with one or more of its partners, but the unitary partners do not own substantially all of the interest in the partnership, the partnership should not be included on a Schedule UB with the partners. Substantial ownership is defined as owning more than 90 percent of all the interest in the partnership. If a Schedule UB should not be filed, each unitary partner must determine the portion of its business income taxed by Illinois by adding its share of that partnership's business income and apportionment factors (Illinois and everywhere) to its own business income and apportionment factors (Illinois and everywhere). This rule applies to you if you are unitary with one or more of your partners or if you are a partner in another partnership and are engaged in a unitary business with that partnership. See 86 Ill. Adm. Code Section 100.3380(d), for more information.

If the following applies, you must file a Schedule UB: If you are a partnership who is a shareholder in a corporation and are engaged in a unitary business with that corporation, or if you are owned more than 90 percent by members of your unitary business group (determined without regard to the rule prohibiting taxpayers who use different apportionment formulas from being included in a unitary business group and the rule prohibiting taxpayers conducting 80 percent or more of their business activities outside the United States from being included in a unitary business group), and you:

- use the same taxable year as a combined group that includes your partners or your subsidiary, you should use the Schedule UB prepared by the combined group in completing your Form IL-1065;

- use a different taxable year from the combined group that includes your partners or your subsidiary, or there is no combined group, you must complete your own Schedule UB using your own taxable year.

Indiana

Ind. Code § 6-3-2-2(a)

Income from a pass through entity shall be characterized in a manner consistent with the income's characterization for federal income tax purposes and shall be considered Indiana source income as if the person, corporation, or pass through entity that received the income had directly engaged in the income producing activity. Income that is derived from one (1) pass through entity and is considered to pass through to another pass through entity does not change these characteristics or attribution provisions. In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter), only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (s) is considered derived from sources within Indiana. Income derived from Indiana shall be taxable to the fullest extent permitted by the Constitution of the United States and federal law, regardless of whether the taxpayer has a physical presence in Indiana.

45 Ind. Admin. Code 3.1-1-106(b)(2)

The distributive share of a nonresident partner will be reported after apportionment to determine the partnership income derived from sources within Indiana. This determination will be accomplished by use of the apportionment formula described in IC 6-3-2-2(b).

45 Ind. Admin. Code 3.1-1-153

(a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.

(b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year, with the following modifications:

(b)(1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.

(b)(2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:

(b)(2)(A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.

(b)(2)(B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.

(c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:

(c)(1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.

(c)(2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.

(d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

The Indiana Supreme Court discussed such a form-over-function situation in Park 100 Dev. Co. v. Ind. Dep't of State Revenue, 429 N.E.2d 220 (Ind. 1981). In Park 100, the Indiana Supreme Court was faced with a situation in which a partnership was itself a partner in a partnership and, on that ground sought to avoid Indiana taxes. Id. at 223. In other words, one pass-through entity was owned by another pass-through entity. The Indiana Supreme Court held that a partnership could not avoid its Indiana tax obligations by becoming a partner in a different partnership (essentially stacking partnerships to avoid tax) and funneling the business receipts through these pass-through entities. Id. at 223. Thus, using tiered pass-through entities to funnel income to another partner did not obviate the taxpayer's tax obligation. Id. The court reasoned that passing income through multiple layers of partnerships does not cancel the tax liability associated with the original partnership's income. Id. As the court explained, "[T]he legislature did not intend for a corporation to escape the corporate tax liability indirectly by forming a two-tiered partnership when it did not allow a corporation to escape that liability as a direct or first-tier partner." Id.

Like the taxpayer in Riverboat Development, Inc., the taxpayers in Park 100 owned a minority ownership interest in the pass-through entity generating the taxable income. Nevertheless, the tax liability still passed through to the owners. Moreover, the court was not persuaded by the fact that the tax liability stemmed from the taxpayer's intangible interest in a partnership. The court's ultimate concern was avoiding the creation of law that would lead to untenable results, such as avoiding tax liabilities by funneling income through a partnership. At no point in the Park 100 decision did the court suggest that the character of the income, and resulting tax liability, was dependent upon whether the taxpayer's ownership interest in the partnership was tangible or intangible in nature. Nor was there any reason for the court to consider the tangible or intangible nature of the ownership, because the focus was the character of the business income earned by the pass-through entity.

Additionally, in Five Star Concrete, L.L.C. v. Klink, Inc. 693 N.E.2d 583 (Ind. Ct. App. 1998), the Indiana Court of Appeals explained that LLCs are like partnerships, and like partnerships the "income 'passes through' the entity and is taxed to the member, an owner of an interest in the company." Id. at 586. The court was very specific–LLCs, like partnerships, pass-through income to their members to be taxed in the same manner as partnerships. The court also noted that there was no dispute that the company properly passed its income and tax liability to its owners. Id. Therefore, like the Park 100 decision, the end result is that the income and the related tax liability of flow through entities that are taxed as partnerships are the responsibility of the partners/members, and the manner in which the taxpayer chooses to define its ownership interest in the company is not relevant for purposes of applying the tax liability . . .

In conclusion, the Department adjusted Taxpayer's adjusted gross income tax return because Taxpayer had failed to include the activities from the two Indiana fabrication plants (one operated by Taxpayer's Division and the other operated by Partnership) in its apportionment factors. Taxpayer, as the reporting entity for Taxpayer's Division, must include the income and activities of the Indiana fabrication plant operated by Taxpayer's Division in its adjusted gross income tax return, including the apportionment factors. IC § 6-3-2-2. In addition, Taxpayer, as the reporting entity for Taxpayer's Division, is a corporate partner in Partnership. Taxpayer, as the corporate partner, is liable for Partnership's adjusted gross income tax in its separate or individual capacity and is required to report its portion of Partnership's Indiana business activity on Taxpayer's Indiana adjusted gross income tax return, pursuant to IC § 6-3-4-11(a). Since Taxpayer owns ninety-nine percent of Partnership, Taxpayer is required to report its ninety-nine percent partner share of Partnership's income and activities in its apportionment factors, as provided in 45 IAC 3.1-1-153. Therefore, Taxpayer's protest of the

Department's adjustments to its return to include the operational business income and activities of the two Indiana fabrication plants in Taxpayer's apportionment factors is denied.

Indiana Revenue Ruling 2001-04IT (February 19, 2001)

It is clear from the above regulations that all of a partnership's income is subject to apportionment. Portfolio interest, net Internal Revenue Code Section 1231 loss, long-term capital gain from the sale of securities and from the sale or exchange of goodwill and going concern value, as components of partnership income, therefore, are subject to apportionment at the partnership level.

Indiana Letter of Findings 06-0524 (01/01/2006)

Taxpayer properly deducted "704(c) property" depreciation in reporting its distributive share of partnership income.

Iowa

Iowa Admin. Code r. 701-503.6(5)

A corporation's distributive share of net income or loss from a joint venture, limited liability company, or partnership is subject to apportionment within and without the state. If the income of the partnership, limited liability company, or joint venture is received in connection with the taxpayer's regular trade or business operations, the partnership, limited liability company, or joint venture income shall be apportioned within and without Iowa on the basis of the taxpayer's business activity ratio. The corporation's distributive share of the gross receipts of the partnership, limited liability company, or joint venture shall be included in the computation of the business activity ratio in accordance with the provisions of this chapter.

EXAMPLE 1: A, a corporation with a commercial domicile in State X, is engaged in business within and without Iowa whereby A sells tangible personal property. A also has an interest in a limited partnership whose business is conducted within and without Iowa. Five percent of the limited partnership's gross receipts are derived from the sale of tangible personal property to Iowa purchasers and 95 percent are derived from sales and deliveries to purchasers outside of Iowa. A will include 5 percent of its distributive share of the gross receipts of the partnership in the numerator along with A's destination Iowa sales in calculating its business activity ratio. A will include 100 percent of its distributive share of the gross receipts in the denominator along with A's total sales in calculating its business activity ratio.

EXAMPLE 2: B, a corporation with a commercial domicile in State X, has no physical presence in the state of Iowa. B's only contact with Iowa is B's interest in a limited partnership whose business is conducted within and without Iowa. Ten percent of the limited partnership's gross receipts are derived from the sale of tangible personal property to Iowa purchasers and 90 percent are derived from sales and deliveries to purchasers outside of Iowa. B will include 10 percent of its distributive share of the gross receipts of the partnership in the numerator in calculating its business activity ratio. B will include 100 percent of its distributive share of the gross receipts in the denominator along with B's total sales in calculating its business activity ratio.

Iowa Admin. Code r. 701-302.12

Residents engaged in a partnership or limited liability company, even if located or doing business outside the state of Iowa, are taxable upon their distributive share of net

income of such partnership or limited liability company, whether distributed or not, and are required to include such distributive share in their return. A nonresident individual who is a member of a partnership or limited liability company doing business in Iowa is taxable on that portion of net income which is applicable to the Iowa business activity whether distributed or not. See 701—Chapter 401.

Iowa Admin. Code r. 701-302.16(4)(a)

> If a nonresident, or a partnership or trust with a nonresident member, transacts business both within and without the state, the net income must be so apportioned as to allocate to Iowa a portion of the income on a fair and equitable basis, in accordance with approved methods of accounting.

Iowa Admin. Code r. 701-302.16(6)

> When a partnership derives income from sources within this state as determined in 302.16(3) through 302.16(5), the nonresident members of the partnership are taxable only upon that portion of their distributive share of the partnership income which is derived from sources within this state.

Iowa Admin. Code r. 701-302.16(9)(b)

> When a nonresident of Iowa sells or exchanges the individual's interest in a partnership, the nonresident is actually selling an intangible since the partnership can continue without the nonresident partner and the assets used by the partnership are legally owned by the partnership and an individual retains only an equitable interest in the assets of the partnership by virtue of the partner's ownership interest in the partnership. However, because of the unique attributes of partnerships, the owner's interest in a partnership is considered to be localized or "sourced" at the situs of the partnership's activities as a matter of law. Arizona Tractor Co. v. Arizona State Tax Com'n., 566 P.2d 1348, 1350 (Ariz. App. 1997); Iowa Code chapter 486 (unique attributes of a partnership defined). Therefore, if a partnership conducts all of its business in Iowa, 100 percent of the gain on the sale or exchange of a partnership interest would be attributable to Iowa. On the other hand, if the partnership conducts 100 percent of its business outside of Iowa, none of the gain would be attributable to Iowa for purposes of the Iowa income tax. In the situation where a partnership conducts business both in and out of Iowa, the capital gain from the sale or exchange of an interest in the partnership would be allocated or apportioned in and out of Iowa based upon the partnership's activities in and out of Iowa in the year of the sale or exchange.

Kansas

Kan. Stat. Ann. § 79-32, 133

> For purposes of this act, a partner's distributive share of partnership income or of any item of income, gain, loss or deduction shall be determined in accordance with his or her distributive share of such item or items as determined for federal income tax purposes: Provided, however, That where a partner's distributive share of an item of partnership income, gain, loss, deduction, or credit is determined for federal income tax purposes by special provision of the partnership agreement with respect to such item, and where the principal purpose of such provision is the avoidance or evasion of tax under this act, the partner's distributive share of such item, and any modification required with respect thereto, shall be determined as if the partnership agreement made no special provision with respect to such item.

Kan. Stat. Ann. § 79-3272

> Any taxpayer having income from business activity which is taxable both within and without this state, other than activity as a financial organization or the rendering of purely personal services by an individual, shall allocate and apportion net income as provided in this act.

Kan. Admin. Regs. § 92-12-83

> All business income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in K.S.A. 79-3279 and 79-4301, article IV.9. The elements of the apportionment formula are the property factor, the payroll factor and the sales factor of the trade or business of the taxpayer.

Kansas Department of Revenue Website

> Information given to the partners receiving income should also include the partner's share of the Kansas and everywhere property, payroll and sales factors of the partnership making the distribution. This information is necessary so the partner receiving the distribution can include those factors with their Kansas and everywhere property, payroll and sales factors in order to properly apportion income to Kansas in their returns when filed.

Kansas Department of Revenue Website and Instructions to Form K-120S

> Business income is apportioned to Kansas generally using the average of the three factors of property, payroll, and sales. For instance, business income received from another partnership is included in your apportionable income and your share of that partnership is multiplied times the property, payroll and sales both in Kansas and everywhere of that partnership to add to your entity's property, payroll and sales both in Kansas and everywhere. The apportionable income is then multiplied by the resulting factor. Any deviation from using the three factor method requires alternative qualifications. All the apportionment methods are listed in this section.
>
> K.S.A. 79-3279 provides that the use of the three-factor method formula of property, payroll, and sales be used to apportion income to Kansas. Direct or segregated accounting methods will not be allowed unless the taxpayer has petitioned the Secretary of Revenue for use of direct or segregated accounting, and the petition is approved. Direct or segregated accounting will not be allowed only because that is the method used in another state or because partnership income is received from other entity.

Kentucky

Ky. Rev. Stat. Ann. § 141.206

> (8) In determining the tax under this chapter, a nonresident individual, estate, or trust that is a partner, member, or shareholder in a pass-through entity required to file a return under subsection (1) of this section shall take into account: (a) 1. If the pass-through entity is doing business only in this state, the partner's, member's, or shareholder's total distributive share of the passthrough entity's items of income, loss, and deduction; or 2. If the pass-through entity is doing business both within and without this state, the partner's, member's, or shareholder's distributive share of the pass-through entity's items of income, loss, and deduction multiplied by the apportionment fraction of the pass-through entity as prescribed in subsection (11) of this section; and (b) The partner's, member's, or shareholder's total distributive share of credits of the pass-through entity.

(9) A corporation that is subject to tax under KRS 141.040 and is a partner or member in a pass-through entity shall take into account the corporation's distributive share of the pass-through entity's items of income, loss, and deduction and:

(a)

1. For taxable years beginning on or after January 1, 2007, but prior to January 1, 2018, shall include the proportionate share of the sales, property, and payroll of the limited liability pass-through entity or general partnership in computing its own apportionment factor; and

2. For taxable years beginning on or after January 1, 2018, shall include the proportionate share of the sales of the limited liability pass-through entity or general partnership in computing its own apportionment factor; and

(b) Credits from the partnership.

(10)

(a) If a pass-through entity is doing business both within and without this state, the pass-through entity shall compute and furnish to each partner, member, or shareholder the numerator and denominator of each factor of the apportionment fraction determined in accordance with subsection (11) of this section.

(b) For purposes of determining an apportionment fraction under paragraph (a) of this subsection, if the pass-through entity is: 1. Doing business both within and without this state; and 2. A partner or member in another pass-through entity; then the pass-through entity shall be deemed to own the pro rata share of the property owned or leased by the other pass-through entity, and shall also include its pro rata share of the other pass-through entity's payroll and sales.

(c) The phrases "a partner or member in another pass-through entity" and "doing business both within and without this state" shall extend to each level of multiple-tiered pass-through entities.

(d) The attribution to the pass-through entity of the pro rata share of property, payroll and sales from its role as a partner or member in another pass-through entity will also apply when determining the pass-through entity's ultimate apportionment factor for property, payroll and sales as required under subsection (11) of this section.

(11)

(a) For taxable years beginning prior to January 1, 2018, a pass-through entity doing business within and without the state shall compute an apportionment fraction, the numerator of which is the property factor, representing twenty-five percent (25%) of the fraction, plus the payroll factor, representing twenty-five percent (25%) of the fraction, plus the sales factor, representing fifty percent (50%) of the fraction, with each factor determined in the same manner as provided in KRS 141.901, and the denominator of which is four (4), reduced by the number of factors, if any, having no denominator, provided that if the sales factor has no denominator, then the denominator shall be reduced by two (2).

(b) For taxable years beginning on or after January 1, 2018, a pass-through entity doing business within and without the state shall compute an apportionment fraction as provided in KRS 141.120.

Ky. Rev. Stat. Ann. § 141.121(6)

A corporation:

(a) That owns an interest in a limited liability pass-through entity; or
(b) That owns an interest in a general partnership;

shall include the proportionate share of receipts of the limited liability pass-through entity or general partnership when apportioning income. The phrases "an interest in a limited liability pass-through entity" and "an interest in a general partnership" shall extend to each level of multiple-tiered pass-through entities.

Louisiana

La. Rev. Stat. Ann. § 47:243(A)(6)

Estates, trusts and partnerships having a non-resident individual or a corporation as a member or beneficiary shall allocate and apportion their income within and without this state in accordance with the processes and formulas prescribed in this Part, and the share of any such non-resident or corporation member or beneficiary in the net income from sources in this state as so computed, shall be allocated to this state in the return of such member or beneficiary.

La. Rev. Stat. Ann. § 47:287.93(A)(5)

For purposes of this Part only, estates, trusts, and partnerships having a corporation as a member or beneficiary shall compute, allocate, and apportion their income or loss within and without this state in accordance with the processes and formulas prescribed by this Part, and the share of any corporation member or beneficiary in the net income or loss from sources in this state so computed shall be allocated to this state in the return of such corporation.

La. Rev. Stat. Ann. § 47:287.92

A. All items of gross income, not otherwise exempt, shall be segregated into two general classes designated as allocable income and apportionable income.

B. Allocable income. The class of gross income to be designated as "allocable income" shall include only the following:

(1) Rents and royalties from immovable or corporeal movable property.

(2) Royalties or similar revenue from the use of patents, trademarks, copyrights, secret processes, and other similar intangible rights.

(3) Income from estates, trusts, and partnerships.

(4) Income from construction, repair, or other similar services.

C. Apportionable income. The class of income to be designated as "apportionable income" shall include all items of gross income which are not properly includable in allocable income as defined in this Section.

La. Rev. Stat. Ann. § 47:202(B)

The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under subsection A(1) through A(3) of this section shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

La. Rev. Stat. Ann. § 47:204

A. Effect of partnership agreement. A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this section, be determined by the partnership agreement.

B. Distributive share determined by income or loss ratio. A partner's distributive share of any item of income, gain, loss, or deduction shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in R.S. 47:202A(4), for the taxable year, if:

(1) the partnership agreement does not provide as to the partner's distributive share of such item, or

(2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such item is the avoidance or evasion of any tax imposed by this chapter.

C. Contributed property.

(1) General rule. In determining a partner's distributive share of items described in R.S. 47:202A, depreciation, depletion, or gain or loss with respect to property contributed to the partnership by a partner shall, except to the extent otherwise provided in sub-section C.(2) or C.(3) of this section be allocated among the partners in the same manner as if such property had been purchased by the partnership.

(2) If the partnership agreement so provides, depreciation, depletion, or gain or loss with respect to property contributed to the partnership by a partner shall, under regulations prescribed by the Collector, be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

(3) Undivided interests. If the partnership agreement does not prove otherwise, depreciation, depletion, or gain or loss with respect to undivided interests in property contributed to a partnership shall be determined as though such undivided interests had not been contributed to the partnership. This paragraph shall apply only if all of the partners had undivided interests in such property prior to making the contribution and their interests in the capital and profits of the partnership correspond with such undivided interests.

D. Limitation on allowance of losses. A partner's distributive share partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

Maine

Me. Stat. tit. 36, § 5191(2)

Each item of partnership income, gain, loss or deduction shall have the same character for a partner under this Part as it has for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Me. Stat. tit. 36, § 5191(3)

> If a partner's distributive share of an item of partnership income, gain, loss or deduction is determined for federal income tax purposes by a special provision in the partnership agreement, the principal purpose of which is the avoidance or evasion of tax under this Part, the partner's distributive share of that item and any modification required with respect to that item must be determined in accordance with the partner's distributive share of the taxable income or loss of the partnership generally, exclusive of items that must be separately computed under the Code, Section 702.

Me. Stat. tit. 36, § 5192(6)

> A nonresident partner's distributive share of items of income, gain, loss or deduction shall be determined under section 5191, subsection 1. The character of partnership items for a nonresident partner shall be determined under section 5191, subsection 2. The effect of a special provision in a partnership agreement, other than a provision referred to in subsection 3, having as a principal purpose the avoidance or evasion of tax under this Part shall be determined under section 5191, subsection 3.

Me. Stat. tit. 36, § 5211(1)

> Any taxpayer, other than a resident individual, estate, or trust, having income from business activity which is taxable both within and without this State, other than the rendering of purely personal services by an individual, shall apportion his net income as provided in this section. Any taxpayer having income solely from business activity taxable within this State shall apportion his entire net income to this State.

18-125 Me. Code R. 801 § .07

> A. Generally. A corporation with an interest in a pass-through entity, such as a partnership, limited partnership, limited liability partnership, limited liability company, S corporation, or other similar entity must include its distributive share of the pass-through entity income, loss, or deduction in calculating its income, in accordance with the Internal Revenue Code and 36 M.R.S. § 5102(8), and must apportion its income pursuant to paragraph D below. The character of any item included in the distributive share is determined as if it were realized or incurred directly by the corporation. The business of the pass-through entity is treated as the business of the corporation.
>
> B. Taxable in Maine. A corporation that is not otherwise subject to Maine's tax jurisdiction is nevertheless taxable in Maine if it is a partner, shareholder or member in a pass-through entity whose activities, if conducted directly by the corporation, would subject the corporation to the Maine corporate income tax.
>
> C. Taxable in another state. A corporation is taxable in another state within the meaning of section .04 above if the corporation is a partner, shareholder or member in a passthrough entity with activities in that state that cause the pass-through entity or its partner, shareholder or member to be taxable in that state under the rules described in section .04 above.
>
> D. Apportionment rules. In general, if a corporate partner, shareholder or member is taxable in another state, it must apportion its taxable net income using the sales factor in 36 M.R.S. § 5211(8).
>
>> (1) Sales factor. In determining the denominator of its sales factor, a corporate partner, shareholder or member must include its pro rata share of the passthrough entity's total sales during the pass-through entity's taxable year. In determining the numerator of its sales factor, a corporate partner, shareholder or member must include its pro rata share of such sales in Maine. To

avoid duplication, however, the following sales must be eliminated from both the numerator and denominator of the sales factor:

> (a) Sales by the corporation to the pass-through entity in an amount equal to the total of such sales multiplied by the corporation's interest in the passthrough entity; and
>
> (b) Sales by the pass-through entity to the corporation in an amount not to exceed the total of all sales made by the pass-through entity multiplied by the corporation's interest in the pass-through entity.

(2) Pro rata share. For purposes of this section, a corporate partner's, shareholder's or member's pro rata share of a pass-through entity's sales shall be its percentage interest in pass-through entity profit or loss for the taxable year, as stated on the partner's, shareholder's or member's Schedule K-1. However, if, under the pass-through entity agreement, a partner's, shareholder's or member's share of gain or loss from the sale of particular pass-through entity assets is different from its profit or loss ratio stated on Schedule K-1, gross receipts from sales of such assets shall be attributed to its sales factor in the same proportion as the partner's, shareholder's or member's interest in gain or loss from the sale. In the event of a termination or other change in a partner's, shareholder's or member's interest during the taxable year, the partner's, shareholder's or member's pro rata share of sales must be modified to reflect pass-through entity sales during the actual period that the partner, shareholder or member held its interest.

Maryland

Maryland Income Tax Administrative Release No. 12 (2008)

Corporate partners that are unitary businesses and have nexus with Maryland are required to allocate their share of partnership income using an appropriate apportionment method. The apportionment method applies if either the corporate partner or the partnership is conducting business in Maryland.

In general, the partnership share of income is apportioned in the same manner as other income allocable to this State. For example, a corporation using a three-factor apportionment formula includes in both the numerator and denominator of each of the factors not only its own property, payroll, and sales, but also adds to such amounts its share of the partnership's property, payroll, and sales. The sales factor is double weighted in the three-factor apportionment formula. The income allocation is then determined by applying the average of the ratios of all property, payroll, and sales (both corporate and partnership) to the corporation's Maryland net income. In this manner, the corporation arrives at its Maryland taxable income attributable to business conducted in Maryland.

The above procedure applies if either the corporation or the partnership is conducting business in this State. For example, a foreign corporation, whose only connection with Maryland is a partnership interest in a partnership that is doing business in Maryland, will report on its Maryland tax return its federal taxable income and compute its Maryland taxable income by use of the apportionment formula that includes the foreign corporation's share of the partnership's apportionment factors, both numerator (Maryland) and denominator (everywhere).

Similarly, a corporation (whether foreign or domestic) that carries on its trade or business in Maryland will compute its apportionment formula by adding to both the

numerator and denominator of the corporation's property, payroll, and sales, the corporate partnership share of the partnership's property, payroll, and sales.

Md. Code Regs. 03.04.03.08(F)(2)

A corporation's share of partnership or joint venture receipts, property, and wages shall be included in the apportionment formula:

(a) To the extent of the factors required; and

(b) In the same manner as if they were direct receipts, property, and wages of the corporation.

Md. Code Regs. 03.04.07.02(D)(1)

A multi-state pass-through entity that is a partnership (including a limited liability company taxed as a partnership and a business trust taxed as a partnership) shall allocate income to this State using:

(a) The apportionment formula for corporations under COMAR 03.04.03.08A—E; or

(b) Separate accounting.

Md. Code Ann., Tax-Gen § 10-401

In computing the adjustments under §§ 10-206 and 10-210 of this title, a nonresident shall allocate to the State income, losses, or adjustments derived in connection with a business that is carried on both in and out of the State and of which the nonresident is a partner, shareholder of an S corporation, or proprietor, or in connection with an occupation, profession, or trade carried on both in and out of the State by:

(1) separate accounting, if the Comptroller allows; or

(2) the method that the Comptroller requires to determine fairly the part of the income derived from or reasonably attributable to the trade, business, profession, or occupation carried on in the State.

Form 511 - Electing Pass-through Entity Income Tax Return Instructions (2023)

Alternative Apportionment: If the apportionment formula does not fairly represent the extent of the PTE's activity within Maryland, the Revenue Administration Division may alter the formula or components accordingly. The corporation may also request the Comptroller's approval to use an Alternative Apportionment Formula.

Massachusetts

830 Mass. Code Regs. 63.38.1

(1)(b) General Rule. All of a taxpayer's taxable net income is allocated to Massachusetts if the taxpayer does not have income from business activity which is taxable in another state. If a taxpayer has income from business activity which is taxable both in Massachusetts and in another state, then the part of its net income derived from business carried on in Massachusetts is determined by multiplying all of its taxable net income by the three factor apportionment percentage as provided in M.G.L. c. 63, § 38(c) through (g) and 830 CMR 63.38.1. If a taxpayer with a Massachusetts commercial domicile has income from business activity which is taxable both in Massachusetts and in another state but also has an income stream that is prohibited from being taxed in

another non-domiciliary state by reason of the U.S. Constitution, that income stream shall be allocated in full to Massachusetts.

(4)(c) Burden of Proof. Except as provided in 830 CMR 63.38.1(4)(d) (relating to corporate limited partners), all income of a single taxpayer (whether derived directly or through agents, partnerships, or other entities whose activities are attributed to the taxpayer) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that, in the aggregate, the related business factors at 830 CMR 63.38.1(4)(b), do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the under
lying assets and their acquisition, maintenance, and management were, in fact, unrelated to the taxpayer's business activities in the Commonwealth.

(4)(d) Presumption of Unrelated Business Activity of Corporate Limited Partners. In cases where a corporate limited partner owns, either directly or indirectly (including all interests of any party whose direct or indirect stock ownership would be attributed to the corporate limited partner under the provisions of 26 U.S. Code § 318), less than 50% of either the capital or profit interests of a partnership and the business activity of the limited partnership is attributed to the corporate limited partner under 830 CMR 63.39.1(8), the business activity of the limited partnership is presumed to be unrelated to the corporation's other business activities unless the Commissioner or the taxpayer rebuts this presumption. If the business activities of the partnership and the corporate limited partner are unrelated, then the corporate limited partner must separately account for its income from the holding or disposition of its limited partnership interest and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity. The separate accounting shall apply both to the determination of income subject to apportionment under M.G.L. c. 63, § 2A, 38 or 42, and to the determination of the non-income measure under M.G.L. c. 63, § 39(a)(1).

Either the Commissioner or a taxpayer may rebut the presumption of unrelated business activity by demonstrating that the corporate limited partner and the partnership are engaged in a unitary business. If a corporate limited partner has engaged in a unitary business with the partnership in one or more taxable years, the corporate limited partner may not separately account in any such taxable year for the income it derives from the partnership. Instead, the corporate limited partner shall apportion to Massachusetts all income derived from business activity carried on within the commonwealth, including income derived from its partnership interest, in accordance with the rules of M.G.L. c. 63, § 2A, 38 or 42 using the corporate limited partner's own property, payroll, and sales plus its pro rata portion of the partnership's property, payroll, and sales to determine an apportionment percentage.

Example 1. Corporation A, which is domiciled outside of Massachusetts, owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Corporation A does not conduct business in Massachusetts. Neither Corporation A nor the Commissioner rebuts the presumption that the business activities of Corporation A and Partnership A are unrelated. Corporation A must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Corporation A's other activities is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income.

Example 2. Corporation B, which is domiciled outside of Massachusetts, conducts business in Massachusetts and, in addition, owns a minority limited partnership interest in Partnership B. Partnership B does not conduct business in Massachusetts. Neither Corporation B nor the Commissioner rebuts the presumption that the business activities of Corporation B and Partnership B are unrelated. Income from Corporation B's holding or disposition of its interest in Partnership B is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income. Corporation B must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities.

Example 3. Corporation C is domiciled in Massachusetts and holds a minority limited partnership interest in Partnership C. Partnership C may or may not be engaged in business in Massachusetts. Neither Corporation C nor the Commissioner rebuts the presumption that the activities of Corporation C and Partnership C are unrelated. Corporation C must separately apportion to Massachusetts income derived from its interest in Partnership C, using the apportionment factors derived from the partnership's activity. Corporation C must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities. The taxable net income of Corporation C is the sum of these separately apportioned amounts.

(12) Corporate Partners. A corporation with an interest in a partnership must include its distributive share of the partnership income, loss, or deduction in calculating its income, in accordance with 26 U.S. Code and M.G.L. c. 63. The character of any item included in the distributive share is determined as if it were realized or incurred directly by the corporation. Except as otherwise provided, the trade or business of the partnership is treated as the trade or business of the corporation. For purposes of determining whether the corporation is a mutual fund service corporation or a Section 38 manufacturer, the corporation's pro rata share (as defined in 830 CMR 63.38.1(12)(f)) of all of the partnership's items, factors and activities shall be taken into account to the extent relevant to the determination, whether or not the corporation and the partnership are engaged in related business activities. If the partnership and corporate partner are engaged in related business activities, the corporation's pro rata share (as defined in 830 CMR 63.38.1(12)(f)) of partnership property, payroll, and sales are included in the partner's apportionment factors, subject to the special rules provided in 830 CMR 63.38.1(12)(d). (Except as otherwise expressly stated, the partnership rules provided in 830 CMR 63.38.1(12) presume that a partnership and corporate partner are engaged in related business activities.)

(a) Taxable in Massachusetts.

1. A corporation that is not otherwise subject to Massachusetts tax jurisdiction is nevertheless taxable in Massachusetts if it is a general partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. See 830 CMR 63.39.1(8).

2. In general, a corporation that is not otherwise subject to Massachusetts tax jurisdiction is taxable in Massachusetts if it is a limited partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. However, as provided in 830 CMR 63.38.1(4)(d), the business activities of the partnership and the corporate limited partner are, in certain circumstances, presumed to be unrelated, so that unless the presumption is rebutted, such partner is taxable in Massachusetts only with respect to the partnership activity. Moreover, under the circumstances described in 830 CMR 63.39.1(8)(b) through (d) (relating to certain partnerships dealing in securities, publicly traded partnerships, and certain de minimis limited partnership holdings), the activities of the partnership are not

attributed to the corporation, and the corporation is not taxable in Massachusetts merely by virtue of holding such a limited partnership interest.

(b) Taxable in Another State. A corporation is taxable in another state within the meaning of 830 CMR 63.38.1(5) if the corporation is a general partner in a partnership with business activities in that state that cause either the partnership or its partners to be taxable in that state described in 830 CMR 63.38.1(5). A corporation that is a limited partner in a partnership with business activity in another state is taxable in another state within the meaning of 830 CMR 63.38.1(5) if and to the extent that the corporation would be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A corporation holding a limited partnership interest in a partnership that does business in another state is taxable in the other state for purposes of apportioning its partnership income, but not for purposes of apportioning income from its other business activities, unless the corporate partner and the partnership are engaged in related business activities, or unless the corporate partner is separately taxable in the other state on the basis of its other (unrelated) business activities.

(c) Income Measure of the Excise. When computing its net income for the taxable year, a corporation must include its distributive share of partnership items for any partnership year ending with or within its taxable year. The following examples illustrate the application of 830 CMR 63.38.1(12)(c):
1. Corporation C holds a 20% profits interest in Partnership P. C's income for the year was $1,000,000 and P's income for the same year was $800,000. The income of C is $1,160,000 ($1,000,000 plus 20% of $800,000).
2. Corporation C holds a 90% profits interest in Partnership P. C incurred a loss of $500,000 for the year but P's income was $1,000,000. The income of C is $400,000 (90% of $1,000,000 = $900,000 less the loss of $500,000).
(d) Special Apportionment Rules. In general, if a corporate partner is taxable in another state, it must apportion its taxable net income using the apportionment percentage in M.G.L. c. 63, § 38. However, the following shall apply:
1. Property Factor. In determining the denominator of its property factor, a corporate partner must include its pro rata share of the total value of the partnership's real and tangible personal property, owned or rented, used during the partnership's taxable year. In determining the numerator of its property factor, a corporate partner must include its pro rata share of the value of such property located in Massachusetts.
a. In order to avoid duplication, however, certain adjustments must be made to the value of any property leased or rented by the corporation to the partnership or vice versa.
i. Where a corporation rents property to the partnership, it must include the original cost of the property in its property factor. No portion of the value of this property as rental property of the partnership is included.
ii. Where the partnership rents property to the corporation, the corporation includes in its property factor the sum of:
A. the original cost of the property multiplied by the corporation's percentage of interest in the partnership; plus
B. eight times the net annual rental rate of the property, multiplied by the difference between 100% and the corporation's percentage of interest in the partnership.
b. The following examples illustrate the application of 830 CMR 63.38.1(12)(d)1.:
i. Corporation C has a 20% profits interest in Partnership P. C owns a building (original cost $100,000) which it rents to Pat a fair market rate of $12,000 per year. C must include the $100,000 original cost of the building in its property factor. No portion of the value of the property as rental property of the partnership is included in C's property factor.
ii. The facts are the same as in the previous example except that P owns the building and rents it to C. C will include $20,000 (20% of $100,000) in its property factor because of its interest in P. C will also include $76,800 ([$12,000 x 8] x 80%) in its

property factor to account for the rented building used in its operations. Thus, the building's value in C's property factor is $96,800 ($20,000, plus $76,800).

2. Payroll Factor. In determining the denominator of its payroll factor, a corporate partner must include its pro rata share of the total compensation paid by the partnership during the partnership's taxable year. In determining the numerator of its payroll factor, a corporate partner must include its pro rata share of such compensation paid in Massachusetts during the taxable year. The following example illustrates the application of 830 CMR 63.38.1(12)(d)2.:

Corporation C has a 20% profits interest in Partnership P. C's own payroll is $1,000,000, half of which is attributable to Massachusetts employees, and P's payroll is $800,000, one quarter of which is attributable to Massachusetts employees. The denominator of C's payroll factor is $1,160,000 ($1,000,000, plus 20% of $800,000, or $160,000). The numerator of C's payroll factor is $540,000 (50% of $1,000,000 plus 25% of $160,000).

3. Sales Factor. In determining the denominator of its sales factor, a corporate partner must include its pro rata share of the partnership's total sales during the partnership's taxable year. In determining the numerator of its sales factor, a corporate partner must include its pro rata share of such sales in Massachusetts.

a. In order to avoid duplication, however, the following sales must be eliminated from both the numerator and denominator of the sales factor:

i. sales by the corporation to the partnership in an amount equal to the total of such sales multiplied by the corporation's profits interest in the partnership; and

ii. sales by the partnership to the corporation in an amount not to exceed the total of all sales made by the partnership multiplied by the corporation's profits interest in the partnership . . .

(f) Pro Rata Share. For purposes of 830 CMR 63.38.1(12), a partner's pro rata share of a partnership's items, factors and activities shall be its percentage interest in partnership profit or loss for the taxable year, as stated on the partner's Schedule K-1, provided however, that if, under the partnership agreement, a partner's share of gain or loss from the sale of particular partnership assets is specially allocated in a manner different from its profit or loss ratio stated on Schedule K-1, and such special allocation has "substantial economic effect" as defined in Treas. Reg. § 1.704-1(b)(2), gross receipts from sales of such assets shall be assigned to its sales factor in the same proportion as the partner's interest in gain or loss from the sale. In the event of a termination or other change in a partner's interest during the taxable year, the partner's pro rata share of payroll and sales must be modified to reflect partnership payroll and sales during the actual period that the partner held its interest.

830 Mass. Code Regs. 62.5A.1(1)

The income of a pass-through entity that derives from or is effectively connected with the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts retains its character as it passes through a tiered structure of pass-through entities before becoming income to the non-resident. Thus, income that is derived from a trade or business does not convert to non-business-related income as it passes through a series of entities. Similarly, Massachusetts source income of any pass-through entities engaged in a unitary business that conducts a trade or business in Massachusetts is taxable to a non-resident member to the extent it would be taxable if received directly by the non-resident.

In the case of multi-tiered unitary businesses where at least one entity in the structure is engaged in the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts, and income derived from one or more members of the unitary business is taxable in another state, the group of entities must apportion its income, as determined under this regulation.

830 Mass. Code Regs. 62.5A.1(2)

Tiered Structure, a pass-through entity that has a pass-through entity as a member. As between two entities, the pass-through entity that is a member is the upper-tier entity, and the entity of which it is a member is the lower-tier entity. A tiered pass-through entity arrangement may have two or more tiers; in such cases, a single entity can be both a lower-tier and an upper-tier entity.

830 Mass. Code Regs. 62.5A.1(3)

The Massachusetts income tax is imposed on the Massachusetts source income earned or derived by non-residents. Massachusetts source income includes the following types of income, but excludes items of income set forth in 830 CMR 62.5A.1(4):

(a) Income Derived from or Effectively Connected with a Trade or Business, Including Any Employment Carried on in Massachusetts. This income is defined as the income that is earned by, credited to, accumulated for or otherwise attributable to the taxpayer's trade or business in the Commonwealth in any year or part thereof, regardless of the year in which the income is actually received by the taxpayer and regardless of the taxpayer's residence or domicile in the year it is received. All types of income, including investment income, derived from or effectively connected with the carrying on of a trade or business within Massachusetts are Massachusetts source income. The term may include gain from the sale of a business or an interest in a business, distributive share income, separation, sick or vacation pay, deferred compensation and nonqualified pension income not prevented from state taxation by the laws of the United States, and income from a covenant not to compete.

1. "Trade or business, including any employment."

a. General Rule. Subject to the exception that applies to presence for business that is casual, isolated, or inconsequential, described at section 830 CMR 62.5A.1(3)(h), below, a non-resident has a trade or business, including any employment carried on in Massachusetts:

i. If the non-resident, directly or through representatives or employees, maintains or operates or shares in maintaining or operating any place in Massachusetts where business affairs are systematically and regularly conducted;

ii. If the non-resident owns an interest in a pass-through entity that, directly or through representatives or employees, or through other pass-through entities, maintains or operates or shares in maintaining or operating any place in Massachusetts where its business affairs are systematically and regularly conducted;

iii. If the non-resident, directly or through representatives or employees, is present for business in Massachusetts either as an employee or as a sole proprietor or other self-employed individual, or if the non-resident owns an interest in a pass-through entity that, directly or through representatives or employees or through other pass-through entities, is present for business. All activities that are considered a "trade or business," including employment, under Massachusetts and/or federal tax law are subject to taxation in Massachusetts under G.L. c. 62, § 5A. Income from a trade or business generally includes that gross income against which trade or business expense deductions are allowable under sections 62 and 162 of the Code. See G.L. c. 62, § 1(l), IRC §§ 62, 162, Treas. Reg. §§ 1.161-1 - 1.162-29;

iv. If the non-resident licenses intangibles, including trademarks or patents, directly or through representatives or employees, for use in Massachusetts on an ongoing basis…

(b) Income from a Pass-Through Entity that is Derived from or Effectively Connected with a Trade or Business, Including Any Employment Carried on in Massachusetts.

1. General rule. The activities of a pass-through entity are attributed to its individual members. A non-resident member of a pass-through entity is therefore engaged in the conduct of the trade or business of the pass-through entity of which it is a member, and thus is taxable on the Massachusetts source income of the entity. The character of any item of income, loss, deduction or credit included in the member's distributive share is determined as if it were realized directly by the member from the source from which realized by the pass-through entity, or incurred in the same manner as incurred by the pass-through entity. The principles in this paragraph shall apply in the case of an ownership chain that runs through multiple pass-through entities. For example, if a non-resident individual is a member of a pass-through entity that, in turn, is a member of a lower-tier pass-through entity that is engaged in a trade or business in Massachusetts, then the non-resident will be taxable on its share of the Massachusetts source income derived from the trade or business conducted by the lower-tier entity.

The income derived by a non-resident limited partner of a Massachusetts limited partnership engaged exclusively in buying, selling, dealing in or holding securities on its own behalf and not as a broker, is not subject to the Massachusetts income tax. See G.L. c. 62, § 17(b). The Massachusetts source income derived by a non-resident general partner of such a partnership is subject to Massachusetts income tax, provided the partnership is engaged in the conduct of a trade or business in the Commonwealth, or owns or leases real property in the Commonwealth.

2. Multiple pass-through entities that are not engaged in a unitary business. In the case of multiple pass-through entities that are not engaged in a unitary business, the pass-through entities must identify the Massachusetts income or loss, reporting that amount to its members, allocated or apportioned as appropriate pursuant to 830 CMR 62.5A.1(6). That income must retain its identity as Massachusetts source income, and be reported as such to members as it passes through multiple pass-through entities, without further apportionment.

Example (3)(b)(2). Florida domiciled LLC ("Florida LLC") has three non-resident members. Florida LLC owns a Massachusetts domiciled LLC ("Massachusetts LLC") that invests in securities on its own behalf and is not engaged in a trade or business. Florida LLC owns a New York domiciled LLC ("New York LLC") that has an office in Boston that offers management services and advice to Massachusetts LLC and receives a fee from Massachusetts LLC based on a percentage of the portfolio value of Massachusetts LLC. Florida LLC also owns Real Estate LLC, commercially domiciled in Utah, but which owns an office tower in Boston and collects rents on that. Real Estate LLC is not engaged in a unitary business with the other members of the group.

Taxation of non-resident members of Florida LLC. The Massachusetts source income of Real Estate LLC, determined pursuant to the allocation and apportionment rules of 830 CMR 62.5A.1(6), is identified and reported to Florida LLC, and is taxable to the non-resident members. It is not subject to further apportionment under 830 CMR 62.5A.1(6) at the level of Florida LLC. Income from Massachusetts LLC is not subject to Massachusetts taxation to the non-resident members, because Massachusetts LLC only invests in securities on its own behalf. The Massachusetts source income derived from New York LLC, determined pursuant to the allocation and apportionment rules of 830 CMR 62.5A.1(6)(a), is taxable because the management company is engaged in the conduct of a trade or business in Massachusetts. The income of the group is not subject to the apportionment provisions described at 830 CMR 62.5A.1(6)(b), below, because the entities subject to Massachusetts taxation are not engaged in a unitary business.

3. Multiple pass-through entities engaged in a unitary business. In the case of multiple pass-through entities that are engaged in a unitary business, the income of any entity in the structure that derives from or is effectively connected with the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts retains its character as it passes through the structure. Thus, business income of a pass-

through entity does not convert to non-business income as it passes through a series of pass-through entities engaged in related business activities, as that term is defined in 830 CMR 62.5A.1(2), and is further explained in 830 CMR 62.5A.1(6). Investment income of a pass-through entity that would be taxable as business income if received directly by a non-resident member engaged in business in Massachusetts is treated as taxable income of the non-resident. Note that business income can include investment income that the pass-through entity or entities derives from an operational function.

Example (3)(b)(3). A non-resident is a member of a Nevada LLC. The Nevada LLC sells computer software, and has an 80% ownership interest in a Partnership that develops computer software in Massachusetts. The partnership is treated as a partnership for federal and Massachusetts tax purposes. The income of the Partnership flows through the LLC to non-resident members. The LLC and the Partnership are functionally integrated, and are a unitary business. Subject to the apportionment rules found at 830 CMR 62.5A.1(6), below, the income of the Partnership that is passed through to the non-resident shareholders is Massachusetts source income.

(c) Specific types of Massachusetts source income. If a non-resident has a trade or business, including any employment, carried on in Massachusetts, Massachusetts source income includes, among other things . . .

830 Mass. Code Regs. 62.5A.1(6)

Rules for Allocation or Apportionment of Income to Massachusetts for Non-resident Members of Pass-through Entities. A pass-through entity that earns or derives income from sources both within Massachusetts and elsewhere must either allocate or apportion the income to determine the amount of Massachusetts source income of its non-resident members, using the following allocation and apportionment provisions. 830 CMR 62.5A 1(6) applies to pass-through entities with non-resident members that have Massachusetts source income. Non-resident individuals use the rules at 830 CMR 62.5A.1(5). The Commissioner may by rule or other public statement create alternate allocation and apportionment methods.

(a) General. A pass-through entity that has income that is taxable both within and outside of Massachusetts must report the member's apportioned share of income to the member. To arrive at the apportioned income figure, the pass-through entity must multiply its taxable net income by the apportionment percentage determined under M.G.L. c. 63, § 38(c) through (g) and 830 CMR 63.38.1. For Massachusetts purposes, the pass-through entity's income subject to apportionment is its entire net income derived from its related business activities, as that term is defined at 830 CMR 62.5A.1(2), and further described at 830 CMR 62.5A.1(6)(d), within and outside of Massachusetts. The entity's income subject to Massachusetts tax is its apportioned net income derived from its related business activities, plus any other income subject to the tax jurisdiction of Massachusetts. Guaranteed payments made to pass-through entity members are treated as other income of the pass-through entity is treated, and are subject to the apportionment rules in 830 CMR 62.5A.1(6)(a).

(b) Treatment of Multiple Pass-through Entities Engaged in a Unitary Business. If a passthrough entity has Massachusetts source income and is related to one or more other pass-through entities in a unitary business, including non-Massachusetts businesses that are in a unitary relationship, the entire income derived from the related activities of the members of the unitary business is subject to Massachusetts apportionment. The method of apportionment is to take the pro rata share of the factors of each entity in the unitary structure, and to aggregate the result for the entire group, according to the method in the following example. The non-resident members will report as Massachusetts source income their apportioned share of income of the entire unitary business.

Example (6)(b)(1.1). General Partnership (General) has a 50% interest in Subsidiary Partnership (Subsidiary); the entities are engaged in a unitary business. General has the following apportionment factors attributable to Massachusetts, presented as a fraction of Massachusetts activity divided by activity everywhere: Property, 25/100; Payroll, 50/100; Sales, 1000/10,000. General has income of $1,000. Subsidiary has the following apportionment factors, presented as a fraction of Massachusetts activity divided by activity everywhere: Property, 10/100; Payroll, 50/100; Sales, 1000/10,000. Subsidiary has a loss of $500. The Massachusetts income of the unitary group is calculated as follows: Income = $1,000 (General's income) - $250 (representing half the loss of Subsidiary; half because General has a 50% interest in Subsidiary) = $750. The $750 income figure must be multiplied by the blended apportionment factors. The blended factors are determined by adding the full factor of General to half the value of Subsidiary's factors (again, because of the 50% ownership). Thus the blended property factor is (25 + 5)/(100 + 50) = 30/150; the blended payroll factor is (50 + 25)/(100 + 50) = 75/150; the blended sales factor (to be counted twice according to the double weighted sales factor rule) is [(1000 + 500)/(10,000 + 5,000)] = 1,500/15,000; the sum of these factors is then divided by four to yield the following result:.2 +.5 +.1 +.1 =.9 / 4 =.225.

(c) Treatment of Income Derived from Unrelated Activities. If the unitary business subject to Massachusetts apportionment has income derived from unrelated business activities, as determined under 830 CMR 62.5A.1(6)(d), these items of income will be excluded from the taxpayer's taxable net income and will not be apportioned to Massachusetts if Massachusetts does not have jurisdiction to tax the items of income under the Constitution of the United States. Income derived from unrelated business activities will be allocated to Massachusetts when the entity's commercial domicile is Massachusetts. The unitary business must report to the non-resident taxpayer, and the non-resident taxpayer must disclose on his or her return, the nature and amount of any item of income that is derived from unrelated business activities and is excluded from (or is excludable from) taxable net income. The taxpayer must also disclose and exclude expenses allocable in whole or part to such unrelated business activities. Any property, payroll, or sales derived from unrelated business activity are excluded from the taxpayer's apportionment factors.

Example (6)(c)(1). Massachusetts LLC owns a commercial real estate property that it leases, both to its parent, a Partnership that gives investment advice to clients, and to other unrelated tenants. The Partnership, in turn, is owned by three Owner LLCs, all of which have a commercial domicile in other states. The Owner LLCs own the interests in the Partnership, as well as other business ventures, such as a manufacturing corporation in South Carolina and a public utility corporation in North Dakota. The manufacturing corporation and the utility corporation are not in a unitary business with other entities, nor do they have any contacts with Massachusetts. The Massachusetts LLC and the Partnership have centralization of management and a flow of value between the entities, and comprise a unitary business. In determining the Massachusetts source income of the Owner LLC members, the Massachusetts LLC and the Partnership must combine their taxable net income and calculate the Massachusetts apportionment percentage based on their combined property, payroll, and sales. The unitary business will exclude the income of the manufacturing corporation and the public utility corporation from this determination, and will not take into account any of the property, payroll, or sales of the two corporations in calculating the Massachusetts apportionment percentage of the unitary business.

(d) Related Business Activities.

1. Definition.

a. General Rule. Related business activities are activities where there is a sharing or exchange of value between the segments of a single entity or multiple entities such that the activities are mutually beneficial, interdependent, integrated, or such that they

otherwise contribute to one another, as generally described under the discussion of the unitary business principle in Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768 (1992). The rules that apply to corporations, found at 830 CMR 63.38.1(4), generally apply to pass-through entities as they are applicable, with certain modifications set forth in 830 CMR 62.5A.1. In general, any two segments or activities of a single pass-through entity are related business activities unless the two segments or activities are not unitary. In addition, the following activities are related business activities notwithstanding the absence of a unitary relationship:

i. the short term investment of capital in a non-unitary business segment or activity; and

ii. any other investment of capital that serves an operational function.

b. Income from Cash, Cash Equivalents, and Short-term Securities. Interest or other income from cash deposits, cash equivalents, and short-term securities is considered related business income if such capital serves or performs an operational function. Without limitation, examples of operational functions include: the use or holding of funds as working capital or reserves; the use or holding of funds to maintain a favorable credit rating (e.g. by maintaining a strong current or quick asset ratio); the use or holding of funds to self-insure against business risks; and the interim investment of funds pending their future use in the taxpayer's business.

2. Burden of Proof. Except as provided in 830 CMR 62.5A.1(6)(d)(3) (relating to passthrough entity limited partners), all income of a single pass-through entity (whether derived directly or through representatives, or other pass-through entities) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that the business activities do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the underlying assets and their acquisition, maintenance, and management were, in fact, unrelated to the pass-through entity's business activities in the Commonwealth.

3. Presumption of Unrelated Business Activity of Pass-through Entity Limited Partners. In cases where a pass-through entity limited partner owns no more than 50% of the capital interests of a partnership, income that the pass-through entity limited partner derives from the holding or disposition of its limited partnership interest is presumed to be unrelated to the pass-through entity's other business activities unless the Commissioner or the taxpayer rebuts this presumption, as provided (and applicable) in 830 CMR 63.39.1(8)(f). If the business activities of the pass-through entity limited partner and the limited partnership are unrelated, then the pass-through entity limited partner must separately account for its limited partnership income and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity.

Example (6)(d)(3.1). Texas LLC owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Texas LLC does not conduct business in Massachusetts. Texas LLC does conduct business in other jurisdictions, either directly or through ownership of other pass-through entities. Neither Texas LLC nor the Commissioner rebuts the presumption that the business activities of Texas LLC and Partnership A are unrelated. Texas LLC must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Texas LLC's other activities is not subject to

Massachusetts tax jurisdiction and is excluded from the Massachusetts source income that it reports to its members.

(e) Special Apportionment Rules for the Gain on the Sale of an Ownership Interest in a Partnership that Holds Real Property in Massachusetts.

1. Partnerships that are Carrying on a Trade or Business in Massachusetts. A nonresident partner who sells an interest in a partnership that both holds an interest in real property in Massachusetts and is carrying on a trade or business in Massachusetts is subject to the general rule at 830 CMR 62.5A.1(3)(c)8., particularly as illustrated at 830 CMR 62.5A.1, Example (3)(c)(8.2).

2. Partnerships that are not Carrying on a Trade or Business in Massachusetts. A non-resident partner who sells an interest in a partnership that holds an interest in real property in Massachusetts but is not carrying on a trade or business in Massachusetts should apply the following rule. The non-resident partner selling his or her interest in the partnership must multiply the gain by a fraction, the numerator of which is the value of the Massachusetts real property and the denominator of which is the total value of the partnership. The value of real property to be used in the fraction is the current fair market value of the property reduced by the value of any lien or encumbrance remaining thereon at the time the partner sells his or her interest in the partnership.

Example (6)(e)(2). Non-resident is a partner in Land Hold, a partnership that purchases land in several states and holds the land for subsequent sale to developers. The partnership was formed with an initial capital contribution from its partners, but was not engaged in the conduct of a trade or business in Massachusetts during the year that Nonresident sells his interest in the partnership. The Massachusetts source income derived from the sale is the total gain from the sale, multiplied by fraction set forth in 830 CMR 62.5A.1(6)(e)(2).

830 Mass. Code Regs. 63.39.1(7)(a)

Except as provided by 830 CMR 63.39.1(7)(b), infra, a business corporation is subject to the excise under M.G.L. c. 63, §§ 2, 2A or 39, if the corporation is a general or limited partner in a partnership whose activities, if conducted directly by the business corporation, would subject that corporation to the corporate excise under the provisions of M.G.L. c. 63, §§ 2, 2A or 39. In the case of a tiered partnership arrangement the activities of the partnership(s) occupying the lower tier(s) are imputed to all partners holding interests in partnership(s) occupying higher tier(s). In applying this provision, the Commissioner will consider whether the assertion of jurisdiction is limited by the provisions of the U.S Constitution or federal law.

Michigan

Mich. Comp. Laws § 206.661(2)

The tax base of a taxpayer whose business activities are confined solely to this state shall be allocated to this state. The tax base of a taxpayer whose business activities are subject to tax both within and outside of this state shall be apportioned to this state by multiplying the tax base by the sales factor calculated under section 663. For a taxpayer that has a direct, or indirect through 1 or more other flow-through entities, ownership interest or beneficial interest in a flow-through entity, the taxpayer's business income that is directly attributable to the business activity of the flow-through entity shall be apportioned to this state using an apportionment factor determined under section 663 based on the business activity of the flow-through entity unless the flow-through entity

is unitary with the taxpayer for apportionment purposes as provided under section 663.

Mich. Comp. Laws § 206.663

(1) Except as otherwise provided in subsection (2) and section 669, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year and the denominator of which is the total sales of the taxpayer everywhere during the tax year. The numerator of a taxpayer shall include its proportionate share of the total sales in this state of a flow-through entity that is unitary with the taxpayer. The denominator of a taxpayer shall include its proportionate share of the total sales everywhere of a flow-through entity that is unitary with the taxpayer. A flow-through entity is unitary with a taxpayer when that taxpayer owns or controls, directly or indirectly, more than 50% of the ownership interests with voting rights or ownership interests that confer comparable rights to voting rights of the flow-through entity, and that has business activities or operations which result in a flow of value between the taxpayer and the flow-through entity, or between the flow-through entity and another flow-through entity unitary with the taxpayer, or has business activities or operations that are integrated with, are dependent upon, or contribute to each other.
(2) Except as otherwise provided under this subsection, for a taxpayer that is a unitary business group, sales include sales in this state of every person included in the unitary business group without regard to whether the person has nexus in this state. Sales between persons included in a unitary business group must be eliminated in calculating the sales factor. Sales between a taxpayer and a flow-through entity unitary with that taxpayer shall, to the extent of the taxpayer's interest in the flow-through entity, be eliminated in calculating the sales factor. Sales between a flow-through entity unitary with a taxpayer and another flow-through entity unitary with that same taxpayer shall, to the extent of the taxpayer's interest in the selling flow-through entity, be eliminated in calculating the sales factor.
(3) It is the intent of the legislature that the tax base of a taxpayer is apportioned to this state by multiplying the tax base by the sales factor multiplied by 100% and that apportionment shall not be based on property, payroll, or any other factor notwithstanding section 1 of 1969 PA 343, MCL 205.581.

Malpass v. Dep't of Treasury, 833 N.W.2d 272 (Mich. 2013)

The Michigan Supreme Court held "that the ITA does not prohibit individual taxpayers from combining the profits and losses from unitary flow-through businesses and then apportioning that income on the basis of the businesses' combined apportionment factors. Moreover, we hold that the ITA did not limit apportionment of income to domestic businesses during the 1994 and 1995 tax years, and that the apportionment could properly be applied to a foreign entity to the extent that the foreign entity and the individual taxpayer's in-state business were unitary." This case allows individuals the freedom to choose combined or separate apportionment on a year-by-year basis.

Minnesota

Minn. Stat. § 290.014

Subd. 4: Except as provided in section 290.015, a partnership is subject to the return filing requirements and to tax as provided in this chapter if the income of the partnership is:

(1) allocable to this state under section 290.17, 290.191, or 290.20;

(2) taxed to the partnership under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary of an estate with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 662(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the partnership directly from the source from which realized by the estate;

(3) taxed to the partnership under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary or grantor or other person treated as a substantial owner of a trust with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 652(b), 662(b), or 664(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the partnership directly from the source from which realized by the trust; or

(4) taxed to the partnership under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a limited or general partner in a partnership with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 702(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the second tier partnership directly from the source from which realized by the first tier partnership.

Subd. 5: Except as provided in section 290.015, corporations are subject to the return filing requirements and to tax as provided in this chapter if the corporation so exercises its franchise as to engage in such contacts with this state as to cause part of the income of the corporation to be:

(1) allocable to this state under section 290.17, 290.191, 290.20, or 290.36;

(2) taxed to the corporation under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary of an estate with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 662(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the corporation directly from the source from which realized by the estate;

(3) taxed to the corporation under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary or grantor or other person treated as a substantial owner of a trust with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 652(b), 662(b), or 664(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the corporation directly from the source from which realized by the trust; or

(4) taxed to the corporation under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a limited or general partner in a partnership with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 702(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the corporation directly from the source from which realized by the partnership.

Minn. Stat. § 290.17

> Subd. 1(a) The income of resident individuals is not subject to allocation outside this state. The allocation rules apply to nonresident individuals, estates, trusts, nonresident partners of partnerships, nonresident shareholders of corporations treated as "S" corporations under section 290.9725, and all corporations not having such an election in effect. If a partnership or corporation would not otherwise be subject to the allocation rules, but conducts a trade or business that is part of a unitary business involving another legal entity that is subject to the allocation rules, the partnership or corporation is subject to the allocation rules.
>
> Subd 4(b) The term "unitary business" means business activities or operations which result in a flow of value between them. The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a sole proprietorship, a corporation, a partnership or a trust.
>
> Subd 4(g) For purposes of determining the net income of a unitary business and the factors to be used in the apportionment of net income pursuant to section 290.191 or 290.20, there must be included only the income and apportionment factors of domestic corporations or other domestic entities that are determined to be part of the unitary business pursuant to this subdivision, notwithstanding that foreign corporations or other foreign entities might be included in the unitary business; except that the income and apportionment factors of a foreign entity, other than an entity treated as a C corporation for federal income tax purposes, that is included in the federal taxable income, as defined in section 63 of the Internal Revenue Code as amended through the date named in section 290.01, subdivision 19, of a domestic corporation, domestic entity, or individual must be included in determining net income and the factors to be used in the apportionment of net income pursuant to section 290.191 or 290.20.

Minn. Stat. § 290.0922, subd. 4 (Minimum Fee)

> For the purposes of this section, a partner's pro rata share of a partnership's property, payroll, and sales or receipts is not included in the property, payroll, and sales or receipts of the partner.

Minnesota Revenue Notice 08-03 (February 19, 2008)

> Partnership income is included in the corporate partner's Minnesota income in one of two ways.
>
> Partnership income is subject to apportionment as business income of the unitary business when a unitary business relationship exists between the corporation and the partnership. The determination of the existence of a unitary business must be made under Minnesota Statutes, section 290.17, subdivision 4, except that a corporation need not own more than 50% direct ownership in the partnership to be included in the unitary business. When a corporation and a partnership are engaged in a unitary business, the corporation must include its partnership income in its apportionable business income. The corporation must also include its pro-rata share of the partnership's property, payroll, and sales/receipts located within and outside Minnesota in the corporation's property, payroll, and sales/receipts numerator and denominator.
>
> If the corporation and partnership are not engaged in a unitary business, the corporation must report its partnership income or loss as separately stated income or loss. If the partnership's business is conducted wholly within Minnesota, the corporate partner's share of partnership income or loss must be assigned entirely to Minnesota by the corporate partner. If the partnership business is conducted wholly outside Minnesota, the corporate partner's share of partnership income or loss must be assigned entirely outside Minnesota. If the partnership conducts its business both within and without

Minnesota, the corporate partner's share of partnership income or loss is assigned to Minnesota based on the partnership's property, payroll, and sales/receipts apportionment factors.

Mississippi

Miss. Code Ann. § 27-7-23(b)(2)

> Income derived from trade, business or other commercial activity shall be taxed to the extent that it is derived from such activity within this state. Mississippi net income shall be determined in the manner prescribed by the commissioner for the allocation and/or apportionment of income of foreign corporations having income from sources both within and without the state.

Miss. Code Ann. § 27-7-23(2)(2)(A)

> Except as provided in Sections 27-7-24, 27-7-24.1, 27-7-24.3, 27-7-24.5, 27-7-24.7, 27-7-24.8 and 27-7-24.9, Mississippi Code of 1972, any corporation or organization having business income from business activity which is taxable both within and without this state shall allocate and apportion its net business income as prescribed by regulations enacted by the commissioner. If the business income of the corporation is derived solely from property owned or business done in this state and the corporation is not taxable in another state, the entire business income shall be allocated to this state. A corporation is taxable in another state if, in that state the corporation is subject to a net income tax, or a franchise tax measured by net income, or if that state has jurisdiction to subject the corporation to a net income tax regardless of whether the state does or does not subject the corporation to a net income tax

tit. no. 35 - pt. 3, subpt. 08, ch. 06, Miss. Code R. 302.01(8)

> Royalty income from mineral production must be allocated to the state where production occurred. Partnership income is allocated directly to the state where the partnership gross income or loss occurred.

tit. no. 35 - pt. 3, subpt. 08, ch. 06, Miss. Code R. § 401.04

> If the business activity in respect to any trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer in another state, portion of the net income (or net loss) arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with the further provisions of this regulation, where direct or separate accounting of net income or loss is not feasible.

Missouri

Mo. Rev. Stat. § 143.421

> (1) In determining the adjusted gross income of a nonresident partner of any partnership, there shall be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss, and deduction entering into his federal adjusted gross income, as such part is determined under regulations prescribed by the director of revenue in accordance with the general rules in section 143.181 . . .

(4) The director of revenue may, on application, authorize the use of such other methods of determining a nonresident partner's portion of partnership items derived from or connected with sources in this state, and the modifications related thereto, as may be appropriate and equitable, on such terms and conditions as he may require.

Mo Rev. Stat. § 143.411(2)

> Each item of partnership income, gain, loss, or deduction shall have the same character for a partner under sections 143.005 to 143.998 as it has for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Mo. Code Regs. Ann. tit. 12, § 10-2.190(2)(B)

> The partnership return or S corporation return shall reflect the total income of the partnership or S corporation from all sources and allocate to Missouri that portion of the total income which is derived from or connected with sources in Missouri by using the apportionment formula in sections 32.200 or 143.451, RSMo. The ratio with a numerator of that portion of the total income which is derived from or connected with sources in Missouri and a denominator of the total income of the partnership or S corporation shall be the basis of allocation of each nonresident partner's or nonresident shareholder's income to Missouri by applying that percentage to the total distributable income of each nonresident partner or shareholder based upon his/her percentage of interest in the partnership or S corporation.

Missouri Private Letter Ruling No. LR 4970 (08/05/2008)

> By statutory definition, to be a partnership in Missouri, the entity has to be carrying on a business. Here, the Partnership's trade or business is investing in securities such as stocks, mutual funds, bonds and other investments, even if it has a contractual relationship with a bank to do so. The Partnership incurs income from carrying on its trade or business of investing in Missouri. This income is thus Missouri source income. Because a partnership is a flow-through entity, partners are deemed to be carrying on the trade or business of the partnership. Therefore, income from the Partnership's trade, investing, is Missouri source income for the partners, including Applicant.
>
> Here, Applicant is a nonresident and general partner in the Partnership. As a general partner, Applicant is deemed to be in the Partnership's trade or business. The income Applicant received as a partner is income derived from sources within this state, is attributable to a business carried on in this state, and is thus Missouri source income.

Missouri Private Letter Ruling No. LR 2664 (12/21/2000)

> Applicant is based in Texas. Applicant is a limited partner in a limited partnership (Limited Partnership A), which in turn is a limited partner in another limited partnership (Limited Partnership B), which owns an interest in a hotel in Missouri. Over 99% of Applicant's income comes from Limited Partnership A, which does no business in Missouri. Different general partners manage Limited Partnership A and Limited Partnership B, and none of the general partners are located in Missouri.
>
> ISSUE:
>
> May Applicant apportion income to Missouri based on the actual amount of income generated in Missouri?

RESPONSE:

Applicant may not apportion income to Missouri based on the actual amount of income generated in Missouri.

The use of an apportionment formula within a special method that is predicated upon separate accounting is an inherent conflict of theories. Applicant states in its letter that over 99 percent of Applicant's income comes from Limited Partnership A, which does no business in Missouri. While on the surface, this contention makes separate accounting seem very reasonable, experience shows that the application of standard formula apportionment methods on a consistent year-in-year-out basis not only results in the fairest long-term treatment of a taxpayer, but results in the most equitable apportionment of the tax burden among the various taxpayers doing business within Missouri and other states.

Missouri Department of Revenue Partnership Tax FAQ

What is considered Missouri source income?

Items of income, gain, loss and deduction derived from, or connected with, sources within Missouri are those items attributable to (1) the ownership or disposition of any interests in real or tangible personal property in Missouri or (2) a business, trade, profession or occupation carried on in Missouri. Income from intangible personal property, to the extent that such property is employed in a business, trade, profession or occupation carried on in Missouri, constitutes income derived from sources within Missouri.

Mo Rev. Stat. § 143.411(3)

Where a partner's distributive share of an item of partnership income, gain, loss, or deduction is determined for federal income tax purposes by a special provision in the partnership agreement with respect to such item, and the principal purpose of such provision is the avoidance of tax under sections 143.005 to 143.998, the partner's distributive share of such item and any modification required with respect thereto shall be determined in accordance with his distributive share of the taxable income or loss of the partnership generally (that is, exclusive of those items requiring separate computation under the provisions of Section 702 of the Internal Revenue Code).

Montana

Mont. Code Ann. § 15-30-3302

(2) Except as otherwise provided, each partner of a partnership described in subsection (1)(a), each shareholder of an S. corporation described in subsection (1)(b), and each partner, shareholder, member, or other owner of an entity described in subsection (1)(c), the first-tier pass-through entity, is subject to the taxes provided in this chapter, if an individual, trust, or estate, and to the taxes provided in Title 15, chapter 31, if a C. corporation. If a partner, shareholder, member, or other owner of an entity described in subsection (1) is itself a pass-through entity, any individual, trust, or estate to which the first-tier pass-through entity's Montana source income is directly or indirectly passed through is subject to the taxes provided in this chapter and any C. corporation to which the first-tier pass-through entity's Montana source income is directly or indirectly passed through is subject to the taxes provided in Title 15, chapter 31 . . .

(5) For purposes of this part:

(a) a partnership or S. corporation with business activity occurring both within and outside of this state shall calculate its Montana source income pursuant to the allocation and apportionment provisions contained in Title 15, chapter 31, part 3; and

(b) a disregarded entity that is not owned by an individual, estate, or trust and that has business activity occurring both within and outside of this state shall calculate its Montana source income pursuant to the allocation and apportionment provisions contained in Title 15, chapter 31, part 3.

Mont. Admin. R. 42.9.107

(1) A pass-through entity may have, in addition to income from its own operations or activities, income from one or more other pass-through entities. This rule describes how the pass-through entity must classify its income from its own operations or activities as apportionable or nonapportionable income and how it must report its income from other pass-through entities. For purposes of this rule, "operations income" means the income of a pass-through entity from its own operations or activities and "flow-through income" means its separately and nonseparately stated distributable share of income from other pass-through entities.

(2) Except as provided in (5), each pass-through entity has to separately determine whether its operations income is apportionable or nonapportionable income as those terms are defined in ARM 42.26.206. Once a pass-through entity determines the apportionable or nonapportionable character of its operations income, the entity must then determine what part of this apportionable and/or nonapportionable income is Montana source income. Except as provided in (5) and (6), the operations income retains its character as apportionable or nonapportionable income and as Montana source income regardless of how many other tiers of pass-through entities through which the income is passed.

(3) Except as provided in (5) and (6), flow-through income of a pass-through entity, determined as provided in (1), retains its character as apportionable and/or nonapportionable income and its character as Montana source income.

(4) An entity in a multi-tiered pass-through entity structure may have flow-through income sourced to Montana under the subsections of the definition of "Montana source income" in 15-30-2101, MCA, that address partnership or S corporation income derived from Montana activity or property, reportable on Montana Schedule K-1, and also operations income sourced to Montana as a result of its own business activity under other subsections of that definition of "Montana source income," such as net income from a business, profession, or farming activities carried on in the state. If this occurs the entity must allocate to Montana the flow-through income sourced to Montana and the entity must determine the portion of its operations income that is sourced to Montana as provided in (1) and allocate or apportion that Montana source income under the provisions of ARM 42.9.112.

(5) This rule does not apply to a partnership or disregarded entity whose operations are unitary with the business operations of a corporate partner or disregarded entity owner that is a C corporation whose apportionment factors are included in the computation of the C corporation's apportionment factors as provided in ARM 42.26.228.

(6) Nothing in this rule prevents the department from determining the apportionable or nonapportionable character of an entity's operations income or the Montana source character of its Montana flow-through income sourced to Montana.

Mont. Admin. R. 42.9.112(5) *Sourcing*

A partnership whose operations are unitary with the business operations of a direct or indirect corporate partner and whose apportionment factors are included in the computation of that corporate partner's apportionment factors, pursuant to ARM 42.26.228, are considered a part of the corporate group for the purpose of applying the Finnigan Rule described in ARM 42.26.260.

Mont. Admin. R. 42.26.228

(1) If the operations of a partnership or disregarded entity are unitary with the business operations of a corporate partner or disregarded entity owner, the corporate partner's or owner's pro rata share of the property, payroll, and sales of the partnership or disregarded entity will be included in the computation of the apportionment factors.

(2) The definition of unitary will be the same as the definition of a unitary business as outlined in 15-31-301, MCA. However, the corporate partner or disregarded entity owner need not own in excess of 50% of the partnership or disregarded entity for the partnership or disregarded entity to be unitary.

Mont. Admin. R. 42.26.229

A partnership or disregarded entity that is not part of a unitary business operation of a corporate partner or disregarded entity owner will be treated as follows:

(a) The corporate partner's or disregarded entity owner's share of partnership or disregarded entity income will not be included in apportionable income to be apportioned, but allocated to the states where the partnership or disregarded entity operates based upon the apportionment formula outlined in 15-31-305, MCA.

Pioneer News Group, Co. and Subsidiaries v. State of Montana Dep't of Revenue, Montana Tax Appeal Board Case No. IT-2020-40 (January 20, 2022)

Under the facts of the case, the Board permitted the taxpayer to use the apportionment provisions of the Multistate Tax Compact to source pass-through income in a tiered structure. The Board noted "[w]hile ARM 42.9.107 may be applicable in other situations not at issue here, this Board declines to read this rule in a manner that contradicts or adds to the Compact."

MT common-errors-to-avoid-when-filing-Form-PTE 030824

Schedule K-1

Special Allocations. Special allocations must be specified on the Schedule K-1 for partners with a special allocation. Mark the Special Allocation checkbox on the Schedule K-1 for any partner that has a special allocation for income/loss that does not follow the profit/loss percentage.

Nebraska

Neb. Rev. Stat. § 77-2728

Each item of partnership income, gain, loss, or deduction shall have the same character for a partner under the provisions of the Nebraska Revenue Act of 1967 as it has for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the

source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

316 Neb. Admin. Code § 24-301

301.01 In General
A business entity or unitary group generating income from a business activity that is taxable within Nebraska and subject to tax in at least one other state must apportion its income. The income is apportioned using the sales factor only, as provided in Reg-24-301 through Reg-24-350.
301.02 Apportionable Income
The entire federal taxable income of a corporation, a unitary group, or a partnership is presumed to be apportionable income. The apportionable income includes income arising from transactions and activity of the business, and income arising from tangible and intangible property if the acquisition, management, employment, development, or disposition of the property was related to the operation of the business entity's trade or business.

316 Neb. Admin. Code § 24-305

305.01 Corporations or Partnerships; Apportionment Formula
The federal taxable income, as adjusted under Reg-24-155, Nebraska Adjustments to Taxable Income, of a corporation or partnership operating both within and outside Nebraska is apportioned to Nebraska by using the sales factor of the corporation or partnership. The income of the taxpayer apportioned to Nebraska is determined by calculating the ratio of the taxpayer's sales in Nebraska compared to the total sales of the taxpayer and applying the computed ratio to the federal taxable income, as adjusted, of the taxpayer.

316 Neb. Admin. Code § 24-315

315.01 A business entity which is required to apportion income and has income from a partnership or joint venture (partnership), will calculate its Nebraska sales factor under this regulation. The entire federal taxable income of a corporate taxpayer is subject to apportionment in this state. Nebraska apportionable income includes any income or loss received due to a business entity's interest in a partnership. If neither the corporation nor the partnership is subject to tax in another state, the entire federal taxable income of the business entity is subject to Nebraska tax and will not be apportioned.

315.02 When a business entity is an owner in a partnership, the business entity's apportionment factor must be calculated based on whether or not the business entity and partnership are considered unitary. A unitary determination must be made for each business entity.

315.02A When a partnership has sufficient contacts with a business entity to be considered unitary if it were a corporation, the partnership will be considered unitary with the business entity regardless of the ownership share of the business entity.

315.02A(1) When a business entity and a partnership are considered unitary, the sales factor of the business entity must include the business entity's share of the partnership's sales determined by multiplying the partnership's sales factor numerator and denominator by the business entity's ownership percentage.

315.02A(2) Intercompany sales will be eliminated using calculations made in the following order:

315.02A(2)(a) Intercompany sales will be eliminated based on the percentage of the business entity's ownership of the partnership; except that sales from the partnership

to the business entity or members of the unitary group will be eliminated only to the extent of the business entity's or unitary group's share of total sales of the partnership (See Reg-24-315.02A(4)); and

315.02A(2)(b) If all of the sales from the partnership to the business entity or unitary group are not eliminated based on Reg-24-315.02A(2)(a), the remaining sales in each state will be the same percentage of the sales in the state before any eliminations. (See Reg-24-315.02A(6))

315.02A(2)(c) Any partnership agreements that identify particular activities to a specific owner will not be considered when determining the income of each owner subject to tax in Nebraska . . .

315.02B When a partnership does not have sufficient contacts with a business entity to be considered unitary, the business entity's sales factor must include its share of income from the partnership. The net income distributed from the partnership to the business entity will be included in the denominator and the Nebraska source net income distributed from the partnership to the business entity will be included in the numerator . . .

315.02B(2) The business entity's sales factor does not include sales made by the partnership. Therefore, the business entity's sales factor is not adjusted to eliminate sales made between the business entity and the partnership.

Nebraska Return of Partnership Instructions (2022)

Nebraska source income is determined by apportioning the partnership or LLC income using a single, sales-only factor. Apportionment refers to the division of income between states by the use of a formula containing one or more apportionment factors . . . For partnerships that are only subject to income tax in Nebraska, the amounts entered on lines 1-14 will come directly from the partner's Federal Schedule K-1. For partnerships that are subject to income tax in another state, the amounts entered on lines 1-14 will be the result of the Federal Schedule K-1 amounts multiplied by the partnership's Nebraska apportionment factor.

New Hampshire

New Hampshire taxes partnership income at the entity level, rather than allocating each partner their distributive share.

N.H. Constitution, Part II, Art. 5 Requirements:

"And farther, full power and authority are hereby given and granted to the said general court, from time to time…to impose and levy proportional and reasonable assessments, rates, and taxes, upon all the inhabitants of, and residents within, the said state; and upon all estates within the same…."

Opinion of the Justices, 111 N.H. 206, 209 (1971).

"[I]t is our view that if corporations are to be taxed upon the receipt of income, the tax burden must be shared by others enjoying like privileges."

N.H. Rev. Stat. Ann. § 77-A:1, I

"Business organization" means any enterprise, whether corporation, partnership, limited liability company, proprietorship, association, business trust, real estate trust or other form of organization….

N.H. Rev. Stat. Ann. § 77-A:3, III

When 2 or more related business organizations are engaged in a unitary business, as defined in RSA 77-A:1, XIV, a part of which is conducted in this state by one or more members of the group, the income attributable to this state shall be determined by means of the applicable combined apportionment factors of the unitary business group in accordance with paragraphs I and II.

New Hampshire Department of Revenue Website

For taxable periods ending on or after December 31, 2023, a 7.5% tax is assessed on income from conducting business activity within the State of New Hampshire. For taxable periods ending on or after December 31, 2022, a business organization deriving gross business profits from business activity both within and outside of the State shall apportion gross business profits using the single sales factor. Organizations operating a unitary business must use combined reporting in filing their New Hampshire business tax return.

New Jersey

N.J. Admin. Code § 18:35-1.3(d)(6)

A tiered partnership shall take into account its distributive share of partnership income from any partnership of which it is a member. Once income has been allocated by a partnership, it shall not be reallocated by the partners.

N.J. Admin. Code § 18:7-7.6

(g) For purposes of apportionment (allocation) of corporate income, where the subject corporation and the partnership are not part of a single unitary business, including a business carried on directly by the foreign corporate partner, separate accounting apportionment should be used to arrive at corporate income. If the New Jersey business of the partnership is part of a single unitary business including a business carried on directly by the foreign corporate partner, flow through accounting apportionment should be used with respect to the incomes of the two entities.

(1) Separate accounting apportionment, for purposes of this subsection only, means use of the following method: The corporation's distributive share of the partnership's business income would be apportioned to New Jersey by computing the applicable N.J.S.A. 54:10A-6 apportionment factor for that business by only taking into account the corporate partner's share of the receipts of the business that the partnership carries on directly. Second, the corporation's entire net income, excluding its distributive share of the partnership's income is apportioned to New Jersey by computing the applicable N.J.S.A. 54:10A-6 apportionment factor for that business by only taking into account the receipts (excluding receipts from the partnership namely, receipts from intercompany transactions) of the business that the corporation carries on directly. Third, these two amounts would be added together to arrive at the corporation's entire net income apportioned to New Jersey.

(2) "Flow through accounting apportionment," for the purpose of this section only, means use of the following method: Taxpayer shall separately compute the receipts fractions attributable to the partnership activity. The taxpayer next computes the

receipts fractions attributable to the corporate activity. An allocation factor combining the factors of the corporation and the partnership is then applied to the corporation's entire net income including its distributive share of the partnership's income.

(3) Facts that either singly or in combination may suggest that the corporation and partnership are part of a unitary business and hence that a flow through approach may be appropriate include, without limitation thereto:

i. Substantial intercompany-partnership transactions;

ii. The partnership interest is the only or the most substantial asset of the corporation;

iii. The partnership interest produces all or most of the income of the corporation;

iv. The corporation and the partnership are in the same line of business;

v. There is substantial overlapping of employees and offices; and/or

vi. There is sharing of operational facilities, technology, and/or know-how.

(4) For further information about combined returns and unitary businesses, see N.J.A.C. 18:7-21.

(h) The accounting methods described at (g) above are also applied to domestic corporate partners. If a domestic corporation is a partner in a foreign partnership that does not conduct business in New Jersey, and the corporation's own business and that of the partnership are not unitary, then the corporation's income from the partnership shall not be included in the corporation's tax base, and the partnership's receipts, payroll, and property shall not be considered in determining the apportionment factor to apply to the corporation's income from its own business. If, however, the two businesses are unitary, then the flow through method should be used in apportioning the corporation's income. For further information about combined returns and unitary businesses, see N.J.A.C. 18:7-21 .

(1) Solely for purposes of this section, each regular place of business of a partnership that is unitary with a corporate partner is to be treated as a regular place of business of the corporate partner. Relief pursuant to N.J.A.C. 18:7-8.3 is permitted to domestic partners with respect to partnership income duplicated on a return of a domestic corporate partner filed with another state. By virtue of its subjectivity under the Corporation Business Tax Act, a corporate partner may seek relief under N.J.S.A. 54:10A-8 if the taxpayer believes that tax computed does not result in a fair apportionment.

(i) A "tiered partnership," for the purposes of this section, is a partnership whose partners are partnerships. A corporation that is a partner in a partnership that in turn is a partner in yet another partnership is not immune from New Jersey taxation simply because of the tiered partnership. The ultimate tax burden and loss benefit falls on the corporate partner. The corporation shall file a New Jersey corporation business tax return taking account of its ultimate distributive share of the tiered partnership's income or loss from New Jersey activities.

(j) The classification of partnership items of income, expense, or loss as operational or nonoperational is to be determined in accordance with N.J.S.A. 54:10A-6.1. Whether or not a partnership is unitary or nonunitary with its corporate partner is a different issue from the issue of taxability of operational or nonoperational income or the deductibility of operational or nonoperational expenses or losses.

New Jersey Technical Bulletin 112(R) (May 3, 2024) *Sourcing*

Tiered Partnerships

A tiered partnership in which the lower-tiered partnership is unitary with the upper-tiered partnership (as outlined in N.J.A.C. 18:7-21.2) must use the flow-through method of accounting and sourcing for unitary partnerships as described in N.J.A.C. 18:7-7.6. For a unitary relationship to exist, there must be common ownership between the entities whereby the ownership in the entities, directly or indirectly, is more than a 50% ownership interest. A tiered partnership that is a nonunitary business uses the separate method of accounting and sourcing for nonunitary partnerships as described in N.J.A.C. 18:7-7.6.

New Mexico

NMSA 1978 § 7-4-10(a)

Except as provided in Subsections B and C of this section, all business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

N.M. Code R. § 3.3.11.12

B. A taxpayer's distributive share of nonbusiness and business income shall be allocated and apportioned in accordance with this section (3.3.11.12 NMAC) to determine the portion of the distributive share of income taxable under the New Mexico Income Tax Act unless the taxpayer is qualified to elect, and has elected, to report the income in accordance with 3.3.11.8 NMAC . . .

D. The taxpayer shall apportion the taxpayer's distributive share of the unincorporated business entity's business income to New Mexico by multiplying the taxpayer's distributive share times the New Mexico apportionment percentage determined by application of the Uniform Division of Income for Tax Purposes Act to the entire business income of the unincorporated business entity. If the unincorporated business entity fails to provide the taxpayer with the necessary New Mexico apportionment percentage or information sufficient to enable the taxpayer to calculate the percentage, the taxpayer shall apportion the taxpayer's entire distributive share of business income as if all of the entity's activities, property, payroll and sales were in New Mexico.

New York

N.Y. Tax Law § 210(3)

A corporation that is a partner in a partnership shall compute tax under this article using the aggregate method as defined in the regulations of the commissioner, unless another method for computing such tax is required or allowed by such regulations. Under the aggregate method, a corporation that is a partner in a partnership is viewed as having an undivided interest in the partnership's assets, liabilities, and items of receipts, income, gain, loss and deduction. Under the aggregate method, the corporation that is a partner in a partnership is treated as participating in the partnership's transactions and activities.

N.Y. Comp. Codes R. & Regs. tit. 20, § 9-2.3

(a)(1) Under the aggregate method, the corporation's distributive share (see IRC section 704) of each partnership item of receipts, income, gain, loss, and deduction and the corporation's proportionate part of each partnership asset and liability and each

partnership activity are included in the computation of the corporation's business income base, capital base, and the fixed dollar minimum tax and will have the same source and character in the hands of the corporate partner for article 9-A purposes as such item has in the hands of the partnership for Federal income tax purposes. Where an item, amount or activity of the partnership is not characterized for Federal income tax purposes or is not required to be taken into account for Federal income tax purposes, the source and character of each item, amount or activity of the partnership will be determined as if such item, amount or activity realized, incurred or experienced by the partnership were realized, incurred or experienced directly by the corporate partner . . .

(a)(4) Where a corporation is a partner in an upper tier partnership that is a partner in a lower tier partnership, the source and character of such corporation's distributive share or proportionate part, as the case may be, of each partnership item of receipts, income, gain, loss, deduction, asset, liability, and activity of the upper tier partnership that is attributable to the lower tier partnership retains the source and character determined at the level of the lower tier partnership. Such source and character are not changed by reason of the fact that such item flows through the upper tier partnership to such partner . . .

(b) Business income base. The corporation's distributive share of each partnership item of income, gain, loss, and deduction must be taken into account in the computation of entire net income and the business income base. These amounts must be taken into account in determining the corporation's business income, investment income, and other exempt income.

(c) Capital base. The corporation's proportionate part of each asset and liability of the partnership must be taken into account in the computation of the capital base. These amounts must be taken into account when determining business capital and investment capital. The capital base does not include any amount with respect to the corporation's interest in the partnership itself . . .

(f)(1) A corporation must include its distributive share of the partnership's business receipts when computing its BAF. Its distributive share of the partnership's business receipts during the applicable partnership year should be combined with the corporation's own receipts for the taxable year. The corporation must apportion such combined amounts using the rules specified in section 210-A and of this Subchapter. To the extent an apportionment rule uses a fraction to determine the amount of New York receipts, a corporation must include the distributive share or proportionate parts of any partnership amounts with the corporation's own amounts in such fraction. In addition, netting of gains and losses must be computed on the combined corporation and partnership amounts.

(f)(2) Where a corporation has receipts from sales to a partnership in which it is a partner, the corporation must reduce its receipts from its sales to the partnership by its distributive share of such purchases by the partnership. Where a partnership has receipts from sales to a corporation that is a partner in the partnership, the corporation does not include its distributive share of the partnership receipts from sales to the corporation in its BAF.

(f)(4) In instances where an apportionment rule requires the use of a fraction to compute New York receipts, the corporation must use the sum of its own amounts for the taxable year and its distributive share or proportionate part, as the case may be, of partnership amounts during the applicable partnership year when computing such fractions

N.Y. Comp. Codes R. & Regs. tit. 20, § 9-2.2(c)

> If a corporation is a partner in a partnership ("upper tier partnership") and such partnership is a partner in another partnership ("lower tier partnership") and the corporation has the necessary information to use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and 374 liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership, but does not have the necessary information to use the aggregate method with respect to such items that are attributable to the lower tier partnership, then such corporation must use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership and must use the entity method with respect to such items that are attributable to the lower tier partnership. If there are additional tiers of partnerships, this methodology must be employed at each tier. The corporation will be presumed to have access to the necessary information with respect to a lower tier partnership and will be subject to the provisions of paragraph (2) of subdivision (b) of this section with respect to a lower tier partnership if one or more of the presumptions set forth in subdivision (a) of this section are met at each tier. If the corporation does not meet any of the presumptions set forth in subdivision (a) of this section and does not have access to the necessary information with respect to a lower tier partnership the provisions of paragraph (1) of subdivision (b) of this section will apply.

N.Y. Comp. Codes R. & Regs. tit. 20, § 9-2.4(e) Computation of tax under the entity method.

> A corporation must apportion its distributive share of partnership items of income, gain, loss and deduction included in its business income and its interest in the partnership included in its business capital by its BAF determined under Part 4 of this Subchapter, computed without regard to its distributive share of any partnership items of income, gain, loss or deduction.

Recent New York Regulations providing more detail on aggregate and entity methods
https://www.tax.ny.gov/pdf/rulemaking/dec1123/corpreform/text.pdf

New York Instructions for Form IT-204 (2023)

> Tiered partnerships (Regulation section 137.6) If your partnership is a partner in another partnership (hereinafter referred to as the lower tier partnership), the source and character of the distributive share of each item of your partnership to any partner of your partnership that is attributable to the lower tier partnership retains the source and character determined at the level of the lower tier partnership. Such source and character are not changed by reason of the fact that any such item flows through your partnership to such partner.
>
> Example: Partnership A was a partner in another partnership, B. A is referred to as the upper tier partnership while B is referred to as the lower tier partnership. P was a nonresident individual partner of A. Partnership A was not engaged in a trade or business in New York but partnership B was. Even though partnership A was not carrying on business in New York, it had New York source income from the distributive shares it received from partnership B. The source and character of each item that partnership A received from partnership B retains the source and character determined at the level of partnership B. For instance, if P was a partner of A, and A was a partner of B, nonresident individual partner P would allocate its share of the NY income from B at B's business allocation percentage. Further, if A was engaged in a trade or business in NY, then P would allocate its share of A's income using A's business allocation percentage and P would allocate its share of B's income (which flows to A) at B's business allocation percentage. This allocation method should be reflected on Forms IT-204 and IT-204-IP.

N.Y. Tax Law § 617(c)

(c) New York tax avoidance or evasion. Where a partner's distributive share of an item of partnership income, gain, loss or deduction is determined for federal income tax purposes by special provision in the partnership agreement with respect to such item, and where the principal purpose of such provision is the avoidance or evasion of tax under this article, the partner's distributive share of such item, and any modification required with respect thereto, shall be determined as if the partnership agreement made no special provision with respect to such item.

N.Y. Comp. Codes R. & Regs. Tit. 20 § 117.5

(a) If a partnership agreement provides for an allocation of any item of partnership income, gain, loss or deduction to a partner but the allocation does not have substantial economic effect in accordance with section 704(b) of the Internal Revenue Code, the allocation shall be disregarded for Federal income tax purposes. In such a case, a partner's distributive share of such item is determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances). This treatment and distribution of the item is reflected in each partner's Federal adjusted gross income and therefore in each partner's New York adjusted gross income, even if no New York State personal income tax avoidance or evasion may be involved.

(b) An allocation of an item, amount or activity, even if recognized for Federal income tax purposes, will not be recognized where it has as a principal purpose the avoidance or evasion of New York State personal income tax. Where an allocation is not recognized, the partner's distributive share shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances).

(c) The determination of whether a principal purpose of an allocation of an item, amount or activity is the avoidance or evasion of New York State personal income tax depends on all the surrounding facts and circumstances. Among the relevant circumstances to be considered are the following:

(1) whether the partnership or a partner individually has a business purpose for the allocation;

(2) whether the allocation has substantial economic effect, that is, whether the allocation may actually affect the dollar amount of the partners' shares of the total partnership income or loss independently of the New York State personal income tax consequences;

(3) whether the related items of partnership income, gain, loss or deduction from the same source are subject to the same allocation;

(4) whether the allocation was made without recognition of normal business factors and only after the amount of the allocated item could reasonably be estimated;

(5) the duration of the allocation; and

(6) the overall New York State personal income tax consequences of the allocation.

N.Y. Comp. Codes R. & Regs. Tit. 20 § 137.5

(c) Where a special provision in a partnership agreement (other than the provision referred to in section 137.2 of this Part) has as its principal purpose the avoidance or evasion of New York State personal income tax, each partner's distributive share must be determined in accordance with the provisions of section 117.5 of this Title.

New York TSB-A-09(7)C (May 13. 2009)

> If Petitioner's special allocation of 99.99% of the depreciation deductions to Investor has substantial economic effect and is valid for federal and state tax purposes, then the same allocation of the tangible property component of the Brownfield Redevelopment Tax Credit to Investor is a valid allocation.

North Carolina

N.C. Gen. Stat. § 105-153.4(d)

> In order to calculate the numerator of the fraction provided in subsection (b) of this section for a partner in a partnership or a member of another unincorporated business that has one or more nonresident partners or members and operates in one or more other states, the amount of the partner's or member's distributive share of the total net income of the business, as modified in **G.S. 105-153.5** and **G.S. 105-153.6**, plus any guaranteed payments made to a partner from the partnership that is includable in the numerator is determined in accordance with the provisions of **G.S. 105-130.4**. As used in this subsection, total net income means the entire gross income of the business less all expenses, taxes, interest, and other deductions allowable under the Code that were incurred in the operation of the business.

17 N.C. Admin. Code 5C.1701

> A corporation which is a member of a partnership or joint venture doing business in North Carolina is subject to North Carolina income tax and is required to include in the total net income subject to apportionment and allocation its share of the partnership's net income or net loss to the same extent required for federal income tax purposes.

17 N.C. Admin. Code 05C .1702

> Income shall be classified as nonapportionable income where the corporate partner limits its connection to the partnership to the investment of funds or property and does not regularly or materially participate in the day-to-day operation of the partnership. Where the business of the partnership is directly or integrally related to the business of the corporate partner, the corporate partner's share of the partnership net income is classified as apportionable income. When classified as apportionable income, the corporate partner's apportionment factors shall include its proportionate share of the partnership's property, payroll, and sales. If the income is classified as nonapportionable income, it shall be included in the corporate partner's net taxable income and allocated in accordance with the allocation provisions of G.S. 105-130.4.

North Carolina Administrative Decision No. 97-548 (April 24, 1998)

> Similar to most states, our law and rules do not distinguish between general and limited partners of a partnership. Furthermore, the rules are applicable for all tiers of the partnership structure. Hence, a corporate partner, which otherwise has no activities in this State, is subject to a corporate income and franchise tax on its distributive share of the partnership income if the partnership is "doing business" in North Carolina. The facts of this case clearly establish that the taxpayer is "doing business" in this State under the Department's rules. Here, [Limited Partnership One] is "doing business" in North Carolina by virtue of its ownership interest in [Limited Partnership Two] which operates in this State. The taxpayer, in turn, is "doing business" in North Carolina by virtue of its ownership interest in the [Limited Partnership One] partnership and is therefore subject to the corporate franchise and income tax imposed under G.S. 105-122 and G.S. 105-130.3, respectively.

Regarding the second issue, I find that the pass-through income derived from [Limited Partnership One] is properly classified as apportionable business income to the taxpayer. N.C. ADMIN. CODE tit. 17, r. 5C.1702 states, in pertinent part, that: "... Where the business of the partnership is directly or integrally related to the business of the corporate partner, the corporate partner's share of the partnership net income is classified as business income. When classified as business income, the corporate partner's apportionment factors shall include its proportionate share of the partnership's property, payrolls and sales."

The taxpayer asserts that, in the event a filing requirement is established, the business of [Limited Partnership One] is not directly or integrally related to its business because the taxpayer does not have a unitary relationship with the general partner of the partnership, [Limited Partnership Two], and therefore, the income is properly classified as nonbusiness income. The evidence of record clearly shows that the taxpayer is a passive holding company with a [percentage] limited partnership interest in [Limited Partnership One] and a [percentage] ownership in [Corporation One], the general partner of [Limited Partnership One] and [Limited Partnership Two]. The evidence also shows that [Limited Partnership One] owns a [percentage] limited partnership interest in the operating partnership, [Limited Partnership Two], which owns and operates restaurants in North Carolina. Therefore, the taxpayer and [Limited Partnership One] are directly and integrally related by common ownership. The issues of whether the corporate partner manages the operations of the partnership, or whether the general partner and the limited partner have a unitary relationship are irrelevant to the question of whether the businesses of the taxpayer and [Limited Partnership One] are directly or integrally related. I find that the businesses of the taxpayer and [Limited Partnership One] are directly or integrally related and therefore the income from [Limited Partnership One] constitutes business income to the taxpayer.

The taxpayer further asserts that its pro-rata share of [Limited Partnership One]'s net income should be classified as nonbusiness income allocable to [state other than North Carolina], the state of its commercial domicile, because it limits its connection to [Limited Partnership One] to the mere investment of funds and does not materially participate in the day-to-day operations of the partnerships. However, I am unpersuaded by this argument, which implies that a passive holding company is not a business and does not produce any business income anywhere. A company of this type engages in no other business activity apart from its ownership interest in its investments. Therefore, its principal business activity is its investments, and income derived from those investments is business income.

In any event, under no circumstance would the income from [Limited Partnership One] be allocated to the commercial domicile of the taxpayer as it contends. N.C. ADMIN. CODE tit. 17, r. 5C.1702 provides that the corporate partner's net taxable income be apportioned and/or allocated to this State in accordance with the apportionment and allocation provisions of G.S. 105-130.4. Section (h) of the statute states that: "The income less related expenses from any other nonbusiness activities or investments not otherwise specified in this section is allocable to this State if the business situs of the activities or investments are located in this State." Therefore, even if such income were classified as nonbusiness income to the taxpayer, it would be at least partly allocable to this State and subject to taxation in this State because the situs of some of the restaurants giving rise to the pass-through income is in North Carolina. Under the applicable statute and rules, however, the income from [Limited Partnership One] to is clearly apportionable business income.

Finally, the Department submitted an Attorney General's Opinion dated January 7, 1947 as evidence and support of its long-standing position concerning its treatment of the corporate partner and the identification of the pass-through income of a partnership "doing business" in this State. In addition, the Department has formulated and

issued rules to instruct the corporate partner of a partnership "doing business" in this State of its filing requirements and the proper treatment of the pass-through income from the partnership. These rules clearly establish that the taxpayer is required to file corporate franchise and income tax returns and apportion its business income to this State. Therefore, I find that the denial of the refunds requested on the amended corporate franchise and income tax returns and the proposed assessment for unpaid franchise tax were proper under the facts and law.

North Carolina Corporate Income Tax Directive PD-14-02 (October 10, 2014)

> The Department has recently reviewed its position on apportionment and allocation of partnership income. The Department has determined that the requirement in G.S. 105-153.4(d) to use the ratio calculated under the corporate apportionment formula in G.S. 105-130.4 necessarily includes use of an alternative apportionment method approved by the Secretary as well as use of the statutory apportionment formulas set out in G.S. 105-130.4(i) and G.S. 105-130.4(m) through (s1). The Department has also concluded that it imprudently exercised its authority under G.S. 105-262 and G.S. 105-264 when it required or allowed partnerships to separately account for business activities that were segregated from other business activities. Finally, the Department has determined that in many cases a partnership misconstrued the Department's guidance by segregating a portion of its apportionable income because it employed a method of accounting that clearly reflected the income of a specific activity.
>
> As a result of the review, the Department will revise its partnership income tax return form and instructions for 2014 to remove provisions for reporting income from segregated activities. The Department believes that, under a constitutionally sound apportionment method, income from unitary business activities is apportionable and income from an activity that is not part of the unitary business activities is allocated to the business situs of the activity. Consequently, the partnership tax return form will also be revised to include a line for reporting nonapportionable income from North Carolina sources and a line for reporting apportionable income subject to North Carolina's apportionment factor.
>
> If a partnership believes that the statutory apportionment formula attributes a greater portion of its income to North Carolina tax than is reasonably attributable to its business in this State, it may make a written request with the Secretary of Revenue for permission to use an apportionment formula that it believes is a better method to attribute its income to North Carolina. The procedures set forth in administrative rule T17 NCAC Chapter 5D .0107 through .0115 for a corporation to request an alternative apportionment formula will also apply to a partnership seeking an alternative apportionment formula.

North Carolina Form D-403A Instructions (2022)

> A partnership with one or more nonresident partners whose business activities in N.C. are unified and integrated with its business activities in other states is required to apportion its partnership income to N.C. by multiplying the income by a fraction, the numerator of which is the total sales of the partnership within N.C., and the denominator of which is the total sales of the partnership everywhere during the income year.

North Dakota

N.D. Cent. Code § 57-38-08.1

> (1) A partnership that carries on its business activity entirely within this state shall report all of its income or loss to this state. A partnership that carries on its

business activity within and without this state shall allocate and apportion its income or loss to this state in the same manner as the income or loss of a corporation is allocated and apportioned to the state under chapter 57-38.1.

(2) Resident partners, limited to individuals, estates, and trusts, must report their entire distributive share to this state as provided in subdivision b of subsection 6 of section 57-38-04, and may claim a credit for taxes paid to another state on that portion of their distributive share attributable to and taxed by another state, as provided in subdivision j of subsection 1 of section 57-38-30.

(3) (a) In determining the gross income of a nonresident partner, limited to individuals, estates, and trusts, there must be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss and deduction, or item thereof, entering into the federal taxable income of the partner, as determined under section 57-38-04 . . .

(c)Any modification to federal taxable income described in this chapter that relates to an item of partnership income, gain, loss, or deduction, or item thereof, must be made in accordance with the partner's distributive share, for federal income tax purposes, of the item to which the modification relates, but limited to the partner's portion of the item derived from or connected with sources in this state.

(d) On application, the commissioner may authorize the use of other methods of determining a nonresident partner's portion of partnership items derived from or connected with sources in this state, and the related modifications, as may be appropriate and equitable, on the terms and conditions as it may require.

N.D. Cent. Code § 57-38-04

(4) Income derived from business activity carried on by an individual as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, must be assigned to this state without regard to the residence of the individual if the business activity is conducted wholly within this state. Income derived from gaming activity carried on in this state by an individual must be assigned to this state without regard to the residence of the individual.

(5) Whenever business activity is carried on partly within and partly without this state by a nonresident of this state as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, the entire income therefrom must be allocated to this state and to other states, according to the provisions of chapter 57-38.1 but only according to the apportionment method provided under subsection 1 of section 57-38.1-09, providing for allocation and apportionment of income of corporations doing business within and without this state.

(6)

(a) Income and gains received by a resident of this state from tangible property not employed in the business and from tangible property employed in the business of the taxpayer, if the business consists principally of the holding of the property and the collection of income and gains from the business, must be assigned to this state without regard to the situs of the property.

(b) Income derived from business activity carried on by residents of this state, whether the business activity is conducted as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, must be assigned to this state without regard to where the business activity is conducted, and the provisions of chapter 57-38.1 do not apply. If the taxpayer believes the operation of this subdivision with respect to the taxpayer's income is unjust, the taxpayer may petition the tax commissioner who may allow use of another method of reporting income, including separate accounting.

N.D. Admin. Code 81-03-05.3-03(2)(d) (worldwide)

When apportionable income includes income from a corporation's ownership interest in a general partnership, the corporate partner's share of the partnership's property, payroll, and sales must be included in the group's apportionment factors.

Administrative Practice: For ND, it is our administrative practice that flow through factors should be included in any situation where the passthrough income is considered apportionable business income to the partner/owner. Our interpretation is that the administrative rule above (which identifies a general partnership interest) is but one example of when flow through factors would be appropriate, but not the only circumstance. Our practice is that the propriety of flow through apportionment does not hinge on the "form" of arrangement (general partner versus limited partner), but rather the specific facts and circumstances. As a result, ownership interests in limited partnerships and LLCs may also require flow through apportionment.

North Dakota Tax Website

Apportionment - All income derived from the partnership's activity is business income and is subject to apportionment. For the definitions of business and nonbusiness income, see North Dakota Administrative Code § 81-03-09. North Dakota does not allow for separate accounting.

Ohio

Ohio Rev. Code Ann. § 5733.05(B)

The sum of the corporation's net income during the corporation's taxable year, allocated or apportioned to this state as prescribed in divisions (B)(1) and (2) of this section, and subject to sections 5733.052, 5733.053, 5733.057, 5733.058, 5733.059, and 5733.0510 of the Revised Code:

(1) The net nonbusiness income allocated or apportioned to this state as provided by section 5733.051 of the Revised Code.

(2) The amount of Ohio apportioned net business income, which shall be calculated by multiplying the corporation's net business income by a fraction. The numerator of the fraction is the sum of the following products: the property factor multiplied by twenty, the payroll factor multiplied by twenty, and the sales factor multiplied by sixty. The denominator of the fraction is one hundred, provided that the denominator shall be reduced by twenty if the property factor has a denominator of zero, by twenty if the payroll factor has a denominator of zero, and by sixty if the sales factor has a denominator of zero.

The property, payroll, and sales factors shall be determined as follows, but the numerator and the denominator of the factors shall not include the portion of any property, payroll, and sales otherwise includible in the factors to the extent that the portion relates to, or is used in connection with, the production of nonbusiness income allocated under section 5733.051 of the Revised Code . . .

Ohio Rev. Code Ann. § 5733.057

As used in this section, "adjusted qualifying amount" has the same meaning as in section 5733.40 of the Revised Code.

This section does not apply to divisions (E) and (F) of section 5733.051 of the Revised Code.

Except as otherwise provided in divisions (A) and (B) of section 5733.401 and in sections 5733.058 and 5747.401 of the Revised Code, in making all apportionment, allocation, income, gain, loss, deduction, tax, and credit computations under this chapter and under sections 5747.41 and 5747.43 of the Revised Code, each person shall include in that person's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, if any, apportionable income or loss, property, compensation, and sales, the person's entire distributive share or proportionate share of the items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales of any pass-through entity in which the person has a direct or indirect ownership interest at any time during the pass-through entity's calendar or fiscal year ending within, or with the last day of the person's taxable year. A pass-through entity's direct or indirect distributive share or proportionate share of any other pass-through entity's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales shall be included for the purposes of computing the person's distributive share or proportionate share of the pass-through entity's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales under this section. Those items shall be in the same form as was recognized by the pass-through entity.

Ohio Rev. Code Ann. § 5747.21

(B) Except as otherwise provided under section 5747.212 of the Revised Code, all items of business income and business deduction shall be apportioned to this state by multiplying business income by the fraction calculated under division (B)(2) of section 5733.05 and section 5733.057 of the Revised Code as if the taxpayer's business were a corporation subject to the tax imposed by section 5733.06 of the Revised Code.

(C) If the allocation and apportionment provisions of sections 5747.20 to 5747.23 of the Revised Code or of any rule adopted by the tax commissioner, do not fairly represent the extent of business activity in this state of a taxpayer or pass-through entity, the taxpayer or pass-through entity may request, which request must be in writing accompanying a timely filed return or timely filed amended return, or the tax commissioner may require, in respect of all or any part of the business activity, if reasonable, any one or more of the following

(1) Separate accounting;

(2) The exclusion of one or more factors;

(3) The inclusion of one or more additional factors which will fairly represent the business activity in this state;

(4) The employment of any other method to effectuate an equitable allocation and apportionment of such business in this state. An alternative method will be effective only with approval of the tax commissioner.

The tax commissioner may adopt rules in the manner provided by sections 5703.14 and 5747.18 of the Revised Code providing for alternative methods of calculating business income and nonbusiness income applicable to all taxpayers and pass-through entities, to classes of taxpayers and pass-through entities, or only to taxpayers and pass-through entities within a certain industry

Ohio Rev. Code Ann. § 5747.231

For As used in this section, "adjusted qualifying amount" has the same meaning as in section 5733.40 of the Revised Code.

This section does not apply to division (AA)(5)(a)(ii) of section 5747.01 of the Revised Code.

Except as set forth in this section and except as otherwise provided in divisions (A) and (B) of section 5733.401 of the Revised Code, in making all apportionment, allocation, income, gain, loss, deduction, tax, and credit computations under this chapter, each person shall include in that person's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales, the person's entire distributive share or proportionate share of the items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, *apportionable income or loss, property, compensation, and sales of any pass-through entity in which the person has a direct or indirect ownership interest at any time during the person's taxable year. A pass-through entity's direct or indirect distributive share or proportionate share of any other pass-through entity's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales shall be included for the purposes of computing the person's distributive share or proportionate share of the pass-through entity's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales under this section. Those items shall be in the same form as was recognized by the pass-through entity.

Oklahoma

Okla. Stat. tit. 68, § 2358(A)

(4)(c) income or loss from a business activity which is not a part of business carried on within or without the state of a unitary character shall be separately allocated to the state in which such activity is conducted . . .

(5) The net income or loss remaining after the separate allocation in paragraph 4 of this subsection, being that which is derived from a unitary business enterprise, shall be apportioned to this state on the basis of the arithmetical average of three factors consisting of property, payroll and sales or gross revenue enumerated as subparagraphs a, b and c of this paragraph.

Okla. Admin. Code § 710:50-19-1(a)

(1) Oklahoma source income or loss. When a partnership has source income or loss then that partnership must file a return showing the income or loss applicable to Oklahoma. The partnership shall also furnish a detailed schedule stating the amount of income distributable to each partner from Oklahoma sources.

(2) Duty to file and report; determination of shares. All resident partners must file individual income tax returns with Oklahoma if they are required to file individual Federal Income Tax Returns. All nonresident partners that have gross income of $1,000.00 must file an Oklahoma Return even though their net may actually be a loss. The partnership income for Oklahoma may be apportioned using the three factor formula unless its operations are from real and tangible personal property, such as rents, oil and mining production or royalties, and gains or losses from sales of such property; then the income or loss shall be allocated in accordance with the situs of such property. The partner's distributive share of Oklahoma income or loss shall be the same proportion to the partner's distributive share of income or loss shown on the Federal Partnership Return.

Okla. Admin. Code § 710:50-19-1(a)(15)

(A) Partnership income or loss shall be separately allocated. [See: 68 O.S. § 2358(A)(4)]

(B) The Oklahoma distributive share of partnership income as determined under 68 O.S. § 2358 and 68 O.S. § 2362 shall be allocated to Oklahoma.

Oregon

Or. Rev. Stat. § 316.124

(1) In determining the adjusted gross income of a nonresident partner of any partnership, there shall be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss and deduction (or item thereof) entering into the federal adjusted gross income of the partner, as such part is determined under rules adopted by the department in accordance with the general rules in ORS 316.127 . . .

(4) The department may, on application, authorize the use of such other methods of determining a nonresident partner's portion of partnership items derived from or connected with sources in this state, and the modifications related thereto, as may be appropriate and equitable, on such terms and conditions as it may require.

Or. Rev. Stat. § 314.714(1)

Each item of partnership income, gain, loss or deduction has the same character for a partner as it has for federal income tax purposes. If an item is not characterized for federal income tax purposes, it has the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Or. Admin. R. 150-314-0385

8) The apportionment factors of a corporation that is a member of a partnership, limited liability company treated as a partnership, or unincorporated joint venture (i.e. the "related entity"), that is a part of the corporation's overall business operations, must include the corporation's share of the property, payroll, and sales of the related entity. For the purpose of computing the apportionment factors, transactions between the corporation and the related entity must be eliminated to the extent of the corporation's percentage of interest in the related entity. The corporation's share of the related entity's property, payroll, and sales are based on its percentage of interest in the related entity that is equal to the ratio of its capital account plus its share of the related entity's debt to the total of the capital accounts of all members of the related entity plus total related entity debt. The capital accounts of the members must reflect the average of the accounts for the period of the tax return. The average of the capital accounts may be computed by averaging the beginning and ending balances or monthly balances. Capital accounts of a related entity must be adjusted to reflect a member's adjusted basis in contributed property, rather than fair market value. The corporation's share of a related entity's debt is determined under IRC 752(a) and 752(b) and the regulations thereunder, irrespective of whether or not the related entity is a true partnership.

9) For the purpose of computing the apportionment factors for a consolidated Oregon return, intercompany transactions between a unitary affiliate of a partner or member and the related entity described in section (8) of this rule are treated the same as intercompany transactions directly between the affiliated corporations, to the extent of the corporate partner's or member's ownership share of the related entity. Intercompany transactions between affiliated corporations filing a consolidated Oregon return are eliminated as provided in section (3) of OAR 150-317-0620.

Example: Corporations A, B, and C file a consolidated Oregon return. A and B each own 50 percent of partnership P. P is part of the overall business operations of the three corporations. P buys 80 percent of its raw materials from C. The intercompany sales between P and C must be eliminated from the apportionment formula for the consolidated Oregon return of the corporations. Transactions between C and P are considered to be directly between the three corporations.

Or. Admin. R. 150-314-0510(7)

"Oregon-source distributive income" means the portion of the PTE's modified distributive income that is derived from or connected with Oregon sources. For PTEs operating in Oregon and one or more other states, Oregon-source distributive income is determined by attributing to Oregon sources that portion of the modified distributive income of the PTE, as defined in section (6) of this rule, determined in accordance with the allocation and apportionment provisions of ORS 314.280 or ORS 314.610 to 314.675.

Oregon Revenue Bulletin 2010-02 (March 29, 2010)

Tiered entities: A partnership that isn't otherwise doing business in Oregon may owe the partnership minimum tax if it owns an interest in another partnership—including an LLC classified as a partnership—that is doing business in Oregon. If the partnership is involved in the Oregon business or acts on behalf of the Oregon business, the partnership is doing business in Oregon and subject to the partnership minimum tax. Generally, limited partners aren't involved in a partnership's activities and don't act on behalf of the partnership. Each partnership must look at the facts and circumstances to determine if it's doing business in Oregon for a particular tax year.

Example 4: Albany Associates is a limited partnership doing business in Oregon. Phoenix LLC is classified as a partnership and owns 20 percent of Albany Associates as a limited partner. Phoenix LLC has no other activity, property, or ties to Oregon and doesn't own an interest in any other entity doing business in Oregon. Phoenix LLC isn't involved in the operation of Albany Associates and doesn't perform any actions on behalf of Albany Associates. Phoenix LLC is not doing business in Oregon. Although Phoenix LLC still has Oregon-source income taxable to its owners and must file an Oregon partnership return, it doesn't owe the partnership minimum tax.

Example 5: Detroit LLC owns a 40-percent stake in Ontario Enterprises, an Oregon partnership doing business in Oregon. Detroit LLC files as a partnership and is involved in the operation of Ontario Enterprises. Detroit LLC owes the partnership minimum tax. Bend Associates owns 20 percent of Detroit LLC and manages Detroit LLC's affairs, including its actions as a general partner of Ontario Enterprises. Bend Associates is involved in the activities of Ontario Enterprises; therefore, Bend Associates also owes the partnership minimum tax.

Example 6: Pittsburgh LLC owns 40 percent of Waldport LLC, an Oregon LLC classified as a partnership and doing business in Oregon. Pittsburgh LLC has no involvement in Waldport LLC, which is operated by the other owners. Pittsburgh LLC is not otherwise doing business in Oregon. Pittsburgh LLC doesn't owe the partnership minimum tax. However, Pittsburgh LLC must file a partnership return for Oregon because it has Oregon-source income that flows through to its owners.

Cook v. Oregon Dept. of Rev., No. TC 5298 (Or. Tax Ct. Aug. 17, 2018).

“The obligation for the PTE to withhold is triggered when the PTE has "distributive income from Oregon sources." That, of course, requires the entity to determine, at the entity level, whether it has income from Oregon sources. The entity cannot rely on some later recalculation by an owner or an auditor, done at the owner level, to determine if

the owner has distributive income from Oregon sources in respect of which it has a withholding obligation . . . Nothing in the rule addresses the critical step in the department's method that combines incomes and apportionment factors. In the case of corporate partners, the combination of income and factors from partnerships with other income and factors **[*28]** occurs, if at all, based on the combination requirements effectively included in ORS 317.705 to 317.715. However, as discussed, such combination requires statutory authority beyond UDITPA and no such statutory authority exists in respect of nonresident individuals . . . The court has considered the text of the partnership tax statutes, the context of those statutes, especially the provisions of the PTE statutes and rules, the history of combined reporting in Oregon and the text and context of UDITPA. None of these is consistent with the department position in this case—a position requiring what is essentially combined reporting and apportionment at the owner level.

Pennsylvania

72 P.S. § 7402.2(a)

Except as set forth in subsection (b), for purposes of this article, a corporation's interest in an entity which is not a corporation shall be considered a direct ownership interest in the assets of the entity rather than an intangible interest.

61 Pa. Code § 153.29

(a)(1) When a taxpayer has an interest in a partnership, joint venture, association or other unincorporated enterprise (hereinafter referred to in this section as partnership), the amount of its distributive share of partnership income shall be determined in accordance with the IRC. The taxpayer's interest in the partnership shall, for purposes of Commonwealth corporate taxation, be considered a direct interest in the assets of the partnership rather than an intangible interest. Accordingly, the taxpayer's share of the partnership's payroll, property and sales—as hereafter determined—shall be included in the apportionment factors of the taxpayer unless otherwise excluded by this section.

(a)(2) A taxpayer's partnership interest for the purpose of computing the portion of the partnership's property, payroll and sales to be included in the taxpayer's property, payroll and sales factors shall be determined under the partnership agreement and in accordance with the IRC.

(b)(1) If the separate activities of the taxpayer or the activities of the partnership are sufficient to meet the conditions of section 401(1) of the TRC (72 P.S. § 7404(1)) relating to doing business, carrying on activities, having capital or property employed or used or owning property within this Commonwealth, then the taxpayer will be subject to corporate taxation by the Commonwealth.

(b)(2) If the separate activities of the taxpayer or the activities of the partnership are sufficient to constitute transacting business outside this Commonwealth and render the taxpayer taxable to another state under section 401(3)2.(a)(2) and (3) of the TRC (72 P.S. § 7401(3)2.(a)(2) and (3)), then the taxpayer will be allowed to apportion and allocate its income.

(c)(1) Income arising from transactions and activity in the regular course of the taxpayer's trade or business constitutes business income. The determination of whether a corporate partner's distributive share of partnership income is business income depends upon whether the income arose in the regular course of the taxpayer's trade or

business, determined in accordance with § 153.24 (reserved). The taxpayer's trade or business shall include activities performed in partnership.

(c)(2) The classification of income by the labels customarily given such as interest, rents, royalties, and capital gains, is of no aid in determining whether distributive partnership income is business or nonbusiness income. The income is determined to be either business or nonbusiness income depending upon the relationship to the trade or business of the corporate partner, not of the partnership, as determined by paragraph (1).

(d) A corporate partner entitled to apportionment under subsection (b)(2) shall determine the business income attributable to this Commonwealth by use of a three-factor formula consisting of property, payroll, and sales of the taxpayer including its share of the partnership's property, payroll, and sales for a partnership year ending within or with the taxpayer's tax year as follows. . .

61 Pa. Code § 109.5(a)

If a nonresident individual, or a partnership of which a nonresident individual is a member, carries on a business, trade, profession, or occupation both within and without this Commonwealth, the items of income, gain, loss and deduction attributable to such business, trade, profession, or occupation shall be apportioned and allocated to this Commonwealth on a fair and equitable basis in accordance with approved methods of accounting.

IN RE: Global Equity Shareholder, Pennsylvania Board of Finance and Revenue Decision No. 1617207 (April 9, 2021)

"Petitioner filed the instant petitioner for review of reassessment at the Board of Finance and Revenue on November 28, 2016, again, claiming the above-listed issue. Petitioner contends that its apportionment factor should be [REDACTED]% because it does not conduct any activities or employ anyone in Pennsylvania. Petitioner explains that its ownership in publicly traded pass-through partnerships that do business in Pennsylvania is minimal but it is unable to obtain Pennsylvania-related property and payroll factors.

Conclusion

Petitioner's request for relied is denied because Petitioner failed to meet its burden of proof pursuant to 72 P.S. § 9705.

If a corporation carries on a business both within and without Pennsylvania, the items of income, gain, loss and deduction attributable to such business can be apportioned and allocated to Pennsylvania on a fair and equitable basis in accordance with approved methods of accounting. *See* 72 P.S. § 7401 (3)(2.(a)(2)-(3); 61 Pa. Code § 109.5. Corporations having income from business activity within and without the state are entitled to use three-factor apportionment. *Id.*

When a taxpayer has an interest in a partnership, joint venture, association or other unincorporated enterprise the interest in the partnership shall be considered a direct interest in the assets of the partnership rather than an intangible interest. *See* 72 P.S. § 7602.6; 61 Pa. Code § 153.29. Accordingly, the taxpayer's share of the partnership's payroll, property, and sales shall be included in the apportionment factors of the taxpayers. *Id.*

Every petition for refund or review filed with the Board shall set forth the facts and points of law which the petitioner relies and Petitioner has the burden of proof to supply sufficient evidence to support its claim. 72 P.S. § 9705. Petitioner has not submitted the proportionate share of the property, payroll, and sales factors of all of its investee

partnerships in which it has an ownership interest. Therefore, there is not sufficient evidence to grant this claim."

IN RE: Starfire Holding Corporation, Pennsylvania Board of Finance and Revenue Decision No. 2004864 (April 3, 2017)

> "Petitioner's lower-tier entity income share is not entitled to nonbusiness income treatment. Under the transactional test, the pass-through income is business income because this income was derived from transactions in which Petitioner regularly engaged, investment in securities and in pass-through entities. Welded Tube Company of America v. Com., 101 Pa. Commw. 32, 515 A.2d 988 (1986); 61 Pa. Code § 153.29(c)(1) (taxpayer's regular trade or business include those performed in a partnership). When deriving income from lower-tier entities is viewed in light of Petitioner's past business history, the lower-tier income was derived from the conduct of Petitioner's regular business. Ross-Araco Corp. v. Com., 165 Pa. Commw. 49, 644 A.2d 235 (1994), aff'd, 544 Pa. 74, 674 A.2d 691 (1996) (holding that gain from land sale was nonbusiness income when transaction was only land sale by taxpayer; gain was used to buy government bonds; and land was used only to obtain performance bid bonds, but did not directly produce business income). Petitioner regularly engaged in investment including the acquisition of pa-rtnerships and limited liability companies to accomplish Petitioner's business purposes.
>
> Petitioner did not prove that the acquisition and management of the lower-tier entities producing the income at issue were not integral parts of Petitioner's investment trade or business. Under the clarified functional test, the lower-tier income was business income because the acquisition and management of other entities constituted an integral part of Petitioner's regular trade or business. See 72 P.S. § 7401(3)2.(a)(1)(A); Glatfelter Pulpwood Company v. Com., 61 A.3d 993 (Pa. 2013) (affirming the Commonwealth Court decision). These lower-tier entities were acquired or formed because of Petitioner's investment business and when sold, the gains remained business income.
>
> Petitioner has not shown that it is entitled to multiform/unrelated income treatment. When multistate businesses are conducted in a way that some of the business operations outside Pennsylvania are independent of and do not contribute to the business operations within Pennsylvania, the business may exclude the factors attributable to the outside activity. Com, v. ACF Indus., Inc., 271 A.2d 273, at 280 (Pa. 1970). The burden of proof in a multiform/unrelated income case lies with the taxpayer who must clearly show the unrelated nature of the income it seeks to exclude. See Container Corp. of America v. Franchise Tax Bd. of Cal., 463 U.S. 159, at 180-81 (1983). Petitioner has not demonstrated it is a multiform business and has not proved how its share of lower-tier entity income was unrelated to its Pennsylvania income when these entities were also Petitioner's investments and, thus, Petitioner's request for multiform/unrelated income treatment is denied. See id."

IN RE: New SR Capital Associates LLC, Pennsylvania Board of Finance and Revenue Decision No. 1513962 (July 13, 2016)

> The Petitioner held an interest in more than 150 tiered partnerships or limited liability companies. Five of those entities had Pennsylvania-sourced income. Petitioner appealed the assessment to the Board of Appeals claiming that it did not conduct business in Pennsylvania. Petitioner argued that, although it is had an ownership interest in five entities with Pennsylvania sourced income and expenses, it did not own or rent property or have any employees in the Commonwealth. Consequently, Petitioner argued, it properly reported its apportionment.
>
> The Board ruled "[i]n the instant case, Petitioner indicates it has interests in five entities with Pennsylvania source income. Two of these entities are partnerships. However,

Petitioner failed to include the source income amounts from these partnerships in its apportionment factors. While Petitioner has submitted a revised RCT-101, amending the denominators of its three apportionment factors from "[REDACTED]" to "[REDACTED]," this Board finds that Petitioner has failed to prove its proposed apportionment factor denominator of "[REDACTED]." Importantly, Petitioner has failed to provide federal returns of investee entities to support its proposal. Petitioner failed to provide source documents to reconcile the difference between the factors reported on its two RCT-101's, or any supporting documentation with respect to its total property, payroll or sales figures. Consequently, this Board finds that Petitioner has failed to satisfy its burden of proof pursuant to 72 P.S. § 9705."

Pennsylvania Personal Income Tax Guide – Pass Through Entities

§ 704(b) Special allocations with substantial economic effect. Pennsylvania follows federal treatment.

§ 704(c) Allocations with respect to pre-contribution gain inherent in contributed assets. Pennsylvania follows federal treatment.

Rhode Island

R.I. Gen. Laws § 44-30-15(a)

Partners' modifications. In determining Rhode Island income of a resident partner, any modification described in subsection (b), (c), or (d) of § 44-30-12, which related to an item of partnership income or deduction shall be made in accordance with the partner's distributive share, for federal income tax purposes, of the item to which the modification relates. Where a partner's distributive share of any item is not required to be taken into account separately for federal income tax purposes, the partner's distributive share of the item shall be determined in accordance with his distributive share for federal income tax purposes of partnership taxable income or loss generally.

R.I. Gen. Laws § 44-30-15(b)

Each item of partnership income or deduction shall have the same character for a partner as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

R.I. Gen. Laws § 44-30-15(c)

Where an owner's distributive shares of an item of pass-through entity income, gain, loss or deduction is determined for federal income tax purposes by special provision in the pass-through entity agreement with respect to such item, and where the principal purpose of such provision is the avoidance or evasion of tax under this chapter, the owner's distributive share of such item, and any modification required with respect thereto, shall be determined as if the pass-through entity agreement made no special provision with respect to such item.

R.I. Gen. Laws § 44-30-34(a)

In determining Rhode Island income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with Rhode Island sources of the partner's distributive share of items of partnership income and deduction entering into his or her federal adjusted gross income, as such portion shall be determined

under regulations of the tax administrator consistent with the applicable rules of § 44-30-32.

R.I. Gen. Laws § 44-30-34(c)

Partner's modifications. Any modification described in subsection (b) or (c) of § 44-30-12 which relates to an item of partnership income or deduction, shall be made in accordance with the partner's distributive share for federal income tax purposes of the item to which the modification relates, but limited to the portion of the item derived from or connected with Rhode Island sources.

R.I. Gen. Laws § 44-30-34(d)

Alternate methods. The tax administrator may, on application, authorize the use of any other methods of determining a nonresident's portion of partnership items derived from or connected with Rhode Island sources, and the modifications related thereto, that may be appropriate and equitable, on any terms and conditions that the tax administrator may require.

R.I. Gen. Laws § 44-30-34(e)

Application of rules for resident partners to nonresident partners.

(1) A partner's distributive share of items shall be determined under § 44-30-15(a).

(2) The character of partnership items for a nonresident partner shall be determined under § 44-30-15(b).

(3) The effect of a special provision in a partnership agreement having the principal purpose of avoidance or evasion of Rhode Island personal income tax shall be determined under § 44-30-15(c).

R.I. Gen. Laws § 7-16-73(c)(1)

Any member of the limited liability company during any part of the limited liability company's taxable year shall file a Rhode Island income tax return and shall include in Rhode Island gross income that portion of the limited liability company's Rhode Island income allocable to the member's interest in the limited liability company.

R.I. Gen. Laws § 7-16-73(c)(4)

A non-resident member is required to file a Rhode Island income tax return even though the member's only source of Rhode Island income was that member's share of the limited liability company's income that was derived from or attributable to sources within this state, and the amount of remittance by the limited liability company on behalf of the non-resident member shall be allowed as a credit against that member's Rhode Island income tax liability.

Homart Development Co. v. Norberg, 529 A2d 115 (R.I. 1987)

"The inclusion of this income in Homart's net-income calculation for apportionment purposes necessarily requires that the payroll, property, and receipt factors that gave rise to it be included in the apportionment equation also. Otherwise, the net income is subject to an apportionment ratio that reflects only Homart's in-state and everywhere business activity when, in fact, this income did not arise from Homart's corporate business activity but instead arose out of the partnerships' business activities that were not reflected in the apportionment ratio. Such an inherent and manifest distortion as applied to this taxpayer should have been acknowledged and remedied by the tax administrator as provided for under § 44-11-15."

280 R.I. Code R. § 20-25-9.7(B)

> Treatment of C Corporation's Pass-Through Entity Income. When a partnership or other pass-through entity does not elect to be taxed as a corporation for federal tax purposes and is directly or indirectly held by a corporation, including any member in a combined group, then the business conducted by the partnership or pass-through entity shall be considered the business of the corporation to the extent of the corporation's distributive share of the partnership or pass-through entity income. Such distributive share shall be included in the net income calculations of the corporation and the combined group, and shall be apportioned to Rhode Island for corporate income tax purposes as set forth in this Regulation, consistent with the decision reached by the Rhode Island Supreme Court in *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987).

South Carolina

S.C. Code Ann. § 12-6-600

> An entity treated as a partnership for federal income tax purposes is not subject to tax under this chapter. Each partner shall include its share of South Carolina partnership income on the partner's respective income tax return. All of the provisions of the Internal Revenue Code apply to determine the gross income, adjusted gross income, and taxable income of a partnership and its partners, subject to the modifications provided in Article 9 of this chapter and subject to allocation and apportionment as provided in Article 17 of this chapter.

S.C. Code Ann. Regs. 117-705.1

> Income or loss realized by resident individuals or partnerships from an established business, or from the lease or rental of tangible personal property or real property, the situs of which is in another state, shall be allocated to the state in which the business or property is located. Except, income of a resident individual or partnership, derived from personal services, is allocated to this State as provided in Section 12-6-2220(6).
>
> However, in the case of a resident individual or partnership, conducting a business of a unitary or homogenous nature, partly within and partly without this State, such income or loss is apportioned in accordance with the provisions of Sections 12-6-2250 through 12-6-3360.

Ellis v. S. C. Tax Comm'n, 309 S.E.2d 761 (S.C. 1983)

> By reason of the "pass through" rule, the character of any item of income, gain, loss deduction or credit included in a partner's distributive share of gains and losses shall be the same as if such item was realized directly from the source from which realized or incurred by the partnership. In other words, each item of income, gain, [**763] loss, deduction or credit is treated as if it were realized or incurred by the partner directly from the source without ever having passed through the partnership. If this were not the case, then partners in real estate or other business ventures could not take advantage of depreciation write-offs and other operating expenses or losses.

South Carolina Private Letter Ruling #24-1 (February 21, 2024)

> How should the Taxpayer's sale of an interest in a multistate partnership that does business in South Carolina be reported to South Carolina for income tax purposes . . .
>
> The Taxpayer, a South Carolina resident individual, was an active owner of a tiered pass through entity structure comprised of two limited liability companies that are treated as partnerships for tax purposes. The Taxpayer was a partner in "Management

Partnership," which owned 49% of "Operating Partnership" ("Management Partnership" and "Operating Partnership" are together referred to as the "Partnerships") . . .

The Partnerships conducted business in multiple states, including South Carolina. Operating Partnership was in the business of buying and selling metal alloys. Management Partnership was responsible for carrying out managerial functions for Operating Partnership's business. These functions included business performance reviews; strategic planning; personnel development; and managing supplier and customer relations. Management Partnership received pass through income from Operating Partnership, which was in turn passed through to its partners (including the Taxpayer).

The Taxpayer worked full time as president and executive officer of Management Partnership until he retired at the end of 2013. After retirement, he continued to take part in certain managerial functions on a more limited basis until 2021. In 2021, the Taxpayer sold his interest in Management Partnership. As a result of the sale, the Taxpayer reported a $2.6 million long term capital gain entirely to South Carolina.

In the year of the sale, the Partnerships' South Carolina apportionment ratio was 2.4%. No information was provided about the assets the Partnerships owned at the time of the sale.

The Taxpayer asks if the entire $2.6 million gain on the sale of his partnership interest is a South Carolina gain, or whether a portion of the gain is "out-of-state income/gain." . . .

As a partner, the Taxpayer is in the business of the partnership by reason of the pass through principle. Under this principle, partnership income or loss is not taxed at the entity level, but is passed through to the partners to be included on the partners' returns. The court in *Ellis v. South Carolina Tax Commission* relied on the pass through principle and held "…the character of any item of income, gain, loss deduction or credit included in a partner's distributive share of gains and losses shall be the same as if such item was realized directly from the source from which realized or incurred by the partnership. In other words, each item… is treated as if it were realized or incurred by the partner directly from the source without ever having passed through the partnership." The partnership interest therefore was connected with the Taxpayer's business. Accordingly, the gain from the sale is not allocated to South Carolina under S.C. Code Ann. § 126-2220(5).

It is not possible to determine whether any part of the gain is otherwise allocable under S.C. Code Ann. §§ 12-6-2220 and -2230 because no information is available about the nature of the assets owned by the Partnerships. However, any amount of gain that is not allocated should be apportioned among the states where the business was conducted, including South Carolina, as required by S.C. Code Ann. § 12-6-2240.

The proportion of the business carried on within this State was 2.4% in the year of the sale, so the Taxpayer should apportion 2.4% of the non-allocated gain on the sale of his partnership interest to South Carolina.

Tennessee

Tenn. Code Ann. § 67-4-2012

(a)(3) Except as otherwise provided in this part, for tax years ending on or after December 31, 2023, but before December 31, 2024, net earnings must be apportioned to this state by multiplying the earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus five (5) times the receipts factor, and the denominator of the fraction is seven (7).

(a)(4) Except as otherwise provided in this part, for tax years ending on or after December 31, 2024, but before December 31, 2025, net earnings must be apportioned to this state by multiplying the earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus eleven (11) times the receipts factor, and the denominator of the fraction is thirteen (13).

(a)(5) Except as otherwise provided in this part, for tax years ending on or after December 31, 2025, net earnings must be apportioned to this state by multiplying the earnings by the receipts factor only.

(a)(6) If the application of subdivision (a)(3), (a)(4), or (a)(5) to a tax year results in a lower apportionment ratio than under the application of the apportionment method in subdivision (a)(2) as it applied to tax years ending before December 31, 2023, then a taxpayer may annually elect to apply the apportionment method in subdivision (a)(2) as it applied to tax years ending before December 31, 2023; provided, however, the election must result in a higher apportionment ratio for the tax year, and the taxpayer must have net earnings, rather than a net loss, for that tax year as computed under § 67-4-2006 . . .

(b) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period. For this purpose, "property" includes a taxpayer's ownership share of the real or tangible property owned or rented by any general partnership, or entity treated as a general partnership for federal income tax purposes, in which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its property factor only the real and tangible property owned or used by the limited liability company. "Property" also includes a taxpayer's ownership share of the real or tangible property owned or rented by any limited partnership, subchapter S corporation, limited liability company or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and, therefore, is not subject to Tennessee excise tax. The cost value or rental value of such property shall be determined from the books and records of the entity in which the taxpayer has an interest and such property shall be valued in accordance with subsection (c) . . .

(e) The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period. For this purpose, "compensation" includes a taxpayer's ownership share of the compensation of any general partnership, or entity treated as a general partnership for federal income tax purposes, in which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its payroll factor only the compensation attributed to the limited liability company. "Compensation" also includes a taxpayer's share of any specific compensation of any limited partnership, subchapter S corporation, limited liability company or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and which is not doing business in Tennessee and thus is not subject to Tennessee excise tax . . .

(g) The receipts factor is a fraction, the numerator of which is the total receipts of the taxpayer in this state during the tax period, and the denominator of which is the total receipts of the taxpayer everywhere during the tax period. For this purpose, "gross receipts" includes a taxpayer's ownership share of the gross receipts of any general partnership, or entity treated as a general partnership for federal income tax purposes, in

which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its receipts factor only the gross receipts attributed to the limited liability company. "Gross receipts" also includes a taxpayer's ownership share of gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and thus is not subject to Tennessee excise tax.

Tennessee Revenue Ruling No. 06-06 (March 14, 2006)

For Application of Franchise, Excise Tax Apportionment Formula Statutes to [LP2]

If [LP2] also has tax nexus in another state(s), it will apportion its net earnings and net worth to Tennessee for franchise, excise tax purposes using the property, payroll compensation and receipts apportionment formula previously described.

In addition to its own property, payroll compensation and receipts, [LP2] will include in its apportionment formula for franchise, excise tax purposes, its ownership share of the property, payroll compensation and gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and thus is not subject to Tennessee franchise, excise tax.

Application of Franchise, Excise Tax Apportionment Formula Statutes to [LP1]

The facts presented state that [LP1] has no Tennessee tax nexus. Therefore, it is not subject to franchise, excise tax and will not compute an apportionment formula.

Application of Franchise, Excise Tax Apportionment Formula Statutes to the Taxpayer

If the Taxpayer also has tax nexus in another state(s), it will apportion its net earnings and net worth to Tennessee for franchise, excise tax purposes using the property, payroll compensation and receipts apportionment formula previously described.

In addition to its own property, payroll compensation and receipts, the Taxpayer will include in its apportionment formula for franchise, excise tax purposes, its ownership share of the property, payroll compensation and gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and thus is not subject to Tennessee franchise excise tax.

This will include the following:

1. 100% of its own property, payroll compensation and receipts.

2. 49.49% of [LP1's] property, payroll compensation and receipts.

3. 49.49% of property, payroll compensation and gross receipts passed-through to [LP1] by any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the Taxpayer has an ownership interest, directly or indirectly through [LP1] and that is not doing business in Tennessee and thus is not subject to Tennessee franchise excise tax.

> It is important to note that the Taxpayer's indirect ownership share (49.49% of 99%) of property, payroll compensation and receipts of [LP2] will be excluded from the Taxpayer's apportionment formula because, although the Taxpayer indirectly has an ownership interest in [LP2] through [LP1], [LP2] is doing business in Tennessee and Is subject to Tennessee franchise, excise tax. Thus, none of [LP2's] property, payroll compensation and receipts are passed-through to the Taxpayer.

Vodafone Americas Holdings, Inc. v. Roberts, 486 SW3d 496 (Tenn. 2016) (applying alternative apportionment to a corporate partner).

Texas

Tex. Tax Code Ann. § 171.106(a)

> Except as provided by this section, a taxable entity's margin is apportioned to this state to determine the amount of tax imposed under Section 171.002 by multiplying the margin by a fraction, the numerator of which is the taxable entity's gross receipts from business done in this state, as determined under Section 171.103, and the denominator of which is the taxable entity's gross receipts from its entire business, as determined under Section 171.105.

Tex. Tax Code § 171.1015

> (a) In this section, "tiered partnership arrangement" means an ownership structure in which any of the interests in one taxable entity treated as a partnership or an S corporation for federal income tax purposes (a "lower tier entity") are owned by one or more other taxable entities (an "upper tier entity"). A tiered partnership arrangement may have two or more tiers.
>
> (b) In addition to the tax it is required to pay under this chapter on its own taxable margin, a taxable entity that is an upper tier entity may include, for purposes of calculating its own taxable margin, the total revenue of a lower tier entity if the lower tier entity submits a report to the comptroller showing the amount of total revenue that each upper tier entity that owns it should include within the upper tier entity's own taxable margin calculation, according to the ownership interest of the upper tier entity.
>
> (c) This section does not apply to that percentage of the total revenue attributable to an upper tier entity by a lower tier entity if the upper tier entity is not subject to the tax under this chapter. In this case, the lower tier entity is liable for the tax on its taxable margin.
>
> (d) Section 171.002(d) does not apply to an upper tier entity if, before the attribution of any total revenue by a lower tier entity to an upper tier entity under this section, the lower tier entity does not meet the criteria of Section 171.002(d)(1) or (d)(2).
>
> (e) The comptroller shall adopt rules to administer this section.

34 Tex. Admin. Code § 3.591(e)(20)

> The net distributive income or loss from a passive entity that is included in total revenue is sourced to the principal place of business of the passive entity.

Texas Comptroller's Letter No. 202104018L (April 14, 2021)

> *Tiered Partnership Provisions*
>
> **Can a lower tier entity exclude from total revenue the amount of total revenue that it reports to an upper tier entity under the tiered partnership provisions?**

Yes. However, a lower tier entity may not report total revenue to an upper tier entity if the upper tier entity is not subject to the franchise tax. (Texas Tax Code (TTC) 171.1015.)

Are there any special reports that must be filed if the tiered partnership provision is used?

Each entity (lower and upper tier) that is filing under the tiered partnership provision must submit, along with its franchise tax report, Form 05-175, Texas Franchise Tax Tiered Partnership Report, to show the amount of total revenue that each upper tier entity should include with the upper tier entity's own total revenue.

Is an upper tier entity eligible for the E-Z computation or no tax due report?

The no tax due thresholds and the E-Z computation do not apply to an upper or lower tier entity if, before the attribution of any total revenue by a lower tier entity to an upper tier entity, the lower tier entity does not meet the criteria.

Do the tiered partnership provisions apply if some of the entities in the tiered partnership arrangement are part of a combined group?

The tiered partnership provision is not available if the lower tier entity is included in a combined group.

Do upper tiers and lower tiers have to have the same accounting period to make the tiered partnership election?

No, but the revenue must be allocated to the accounting period on which the report is based.

Is the tiered partnership election in TTC 171.1015 mandatory?

No.

Is the tiered partnership election in TTC 171.1015 an alternative to combined reporting?

No. Combined reporting is mandatory for taxable entities that meet the ownership and unitary criteria. The tiered partnership provisions are not available if the lower tier entity is included in a combined group.

If the tiered partnership election in TTC 171.1015 is made, does the lower tier partnership have to report all revenue to all upper tier entities?

No, a lower tier entity that is not part of a combined group may choose to report total revenue to any or all of its upper tier entities. If the lower tier entity chooses to report total revenue to an upper tier entity, the lower tier entity must report total revenue to the upper tier entity according to the ownership interest of the upper tier entity. A lower tier entity may not report total revenue to an upper tier entity if the upper tier entity is not subject to the franchise tax.

34 Tex. Admin. Code § 3.590

(b)(2)(D) Eligible pass-through entities including partnerships, limited liability companies taxed as partnerships under federal law, limited liability companies that are disregarded under federal law and S corporations are included in a combined group . . .

(b)(2)(E) Passive entities are not included in the combined group; however, the pro rata share of net income from a passive entity shall be included in total revenue to the extent it was not generated by the margin of another taxable entity . . .

(b)(4)(A) Controlling interest means . . .

(ii) for a partnership, association, trust or other entity other than a limited liability company, more than 50%, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership, association, trust, or other entity

(iii) for a limited liability company, either more than 50%, owned directly or indirectly, of the total membership interest of the limited liability company or more than 50%, owned directly or indirectly, of the beneficial ownership interest in the membership interest of the limited liability company.

(b)(4)(B) Examples are as follows. . .

(iii) Individual A owns 100% of 10 corporations, each of which owns 10% of Partnership B. Individual A has a controlling interest in each of the ten corporations and in Partnership B.

(iv) Corporation A holds a 70% interest in Partnership B that owns 60% of Limited Liability Company C. Corporation A owns the remaining 40% of Limited Liability Company C. Corporation A owns a controlling interest in Partnership B and, taking into account Company A's direct and indirect ownership of Limited Liability Company C, a 100% controlling interest in Limited Liability Company C.

(v) Corporation A owns 10% of Limited Liability Company C and 45% of Corporation B, which owns 90% of Limited Liability Company C. Corporation A would hold a 10% interest in Limited Liability Company C which would not constitute a controlling interest. Corporation B has a controlling interest in Limited Liability Company C.

(vi) Partnership P is owned equally by Limited Liability Company A, Limited Liability Company B and Limited Liability Company C. Three unrelated individuals each wholly owns one of the limited liability companies. None of the limited liability companies owns more than 50% of Partnership P. There is no controlling interest.

(vii) Individual A and Individual B each owns 50% of Partnership X. Individual A and Individual B each also owns 50% of Partnership Y. Individual A and Individual B are not husband and wife. Since neither individual owns more than 50% of each partnership, neither individual has a controlling interest in the partnerships.

(b)(4)(F) Membership in more than one group. If an entity is a member of more than one affiliated group, the entity is treated as a member of the affiliated group (or part thereof) with respect to which it has a unitary relationship. If the entity has a unitary relationship with more than one of those affiliated groups, it shall elect to be treated as a member of only one group. The election shall remain in effect until the unitary business relationship between the entity and the other members ceases, or unless revoked with approval of the comptroller.

Utah

Utah Code Ann. § 59-10-1404

Regardless of whether or how an item of income, gain, loss, deduction, or credit is characterized for federal income tax purposes, that item of income, gain, loss, deduction, or

credit is from the same source and incurred in the same manner for a pass-through entity taxpayer as if the item of income, gain, loss, deduction, or credit is:

(1) realized directly from the source from which the item of income, gain, loss, deduction, or credit is realized by the pass-through entity; or
(2) incurred in the same manner as incurred by the pass-through entity.

Utah Code Ann. § 59-10-117(1)(d)

a share of income, gain, loss, deduction, or credit of a nonresident pass-through entity taxpayer, as defined in Section 59-10-1402, derived from or connected with Utah sources shall be determined in accordance with Section 59-10-118 . . .

Utah Code Ann. § 59-10-1402(6)

"Derived from or connected with Utah sources" means:

(a) if a pass-through entity taxpayer is classified as a C corporation for federal income tax purposes, derived from or connected with Utah sources in accordance with Chapter 7, Part 3, Allocation and Apportionment of Income - Utah UDITPA Provisions; or

(b) if a pass-through entity or pass-through entity taxpayer is classified as an estate, individual, partnership, S corporation, or a trust for federal income tax purposes, derived from or connected with Utah sources in accordance with Sections 59-10-117 and 59-10-118.

Utah Admin. Code R865-9I-13(1)

(b) the nonbusiness income of the pass-through entity derived from or connected with Utah sources.

(i) "Nonbusiness income of the pass-through entity derived from or connected with Utah sources" does not include portfolio income if the income would not be reportable to Utah on the pass-through entity taxpayer's Utah state tax return or the Utah state tax return of any downstream pass-through entity taxpayer.

(ii) "Downstream pass-through entity taxpayer" means a pass-through entity taxpayer that is a pass- through entity taxpayer of any entity that is itself a pass-through entity taxpayer.

Utah Admin. Code R865-6F-8(11)(f)

Income or loss from partnership or joint venture interests shall be included in income and apportioned to Utah through application of the three-factor formula consisting of property, payroll and sales. For apportionment purposes, the portion of partnership or joint venture property, payroll and sales to be included in the corporation's property, payroll and sales factors shall be computed on the basis of the corporation's ownership interest in the partnership or joint venture, and otherwise in accordance with other applicable provisions of this rule.

Vermont

Vt. Stat. Ann. tit. 32, § 5920(a)

A partnership or limited liability company, which engages in activities in Vermont that would subject a C corporation to the requirement to file a return under section 5862 of this title, shall file with the Commissioner an annual return, in the form prescribed by

the Commissioner, on or before the due date prescribed for the filing of the entity's federal return. The return shall set forth the name, address, and Social Security or federal identification number of each partner or member; the partnership or limited liability company income attributable to Vermont and the income not attributable to Vermont with respect to each partner or member as determined under this chapter; and such other information as the Commissioner may by rule prescribe. The partnership or limited liability company shall, on or before the day on which such return is filed, furnish to each person who was a partner or member during the year a copy of such information shown on the return as the Commissioner may by rule prescribe.

Vt. Code R. § 10 060 040 [REG. Section 1.5862(d)]

> Section 4(b)(4) Pass-through entities, including partnerships, limited liability companies taxed as partnerships under federal law, and S corporations are not themselves members of the affiliated group. However, a pro rata share of such entity's income and sales, payroll and property is assigned to the unitary group member that holds an ownership interest in such pass-through entity . . .
>
> Section 4(d)(2) voting stock owned by a partnership, other than a limited partnership, is indirectly owned by a partner in proportion to the partner's capital interest in the partnership. For this purpose, a partnership other than a limited partnership is treated as owning proportionately the stock owned by any other partnership or limited partnership in which it has a tiered interest. Voting stock owned by a limited partnership is indirectly owned by the general partner who has authority to determine how the stock is voted . . .
>
> Section 7(d)(2) the taxpayer member's apportionment percentage, determined under Reg. § 1.5833. including in the numerator the taxpayer's property, payroll and sales associated with the combined group's unitary business in Vermont, and including in the denominator the property, payroll and sale of all members of the combined group, including the taxpayer, which property, payroll and sales are associated with the combined group's unitary business wherever located. The property, payroll and sales of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of the partnership's unitary income included in the income of the combined group in accordance with (e)(3) . . .
>
> Section 7(e)(3) If the unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business income . . .

Draft Changes for Reg. §1.5862(d)

> Ex. 2) Same facts as Example 1, but Office Co. enters into an agreement to purchase a 30% interest in Partnership P. The partnership agreement provides that Office Co.'s income distribution from P is also 30%. P is used as Office Co. and Insurance Co.'s main supplier of paper. P engages in unitary activities with the affiliated group. Office Co. is imputed to have engaged in the activities of P. The pro rata net income of P must be included in the combined report as well as the net income of Insurance Co. The pro rata share of apportionment factors of P should be included in Office Co.'s data according to the percentage of income distributed . . .
>
> A unitary business includes that part of the business that meets the definition in this Section 5(a) and is conducted by a taxpayer through the taxpayer's interest in a partnership, whether the interest in that partnership is held directly or indirectly through a series of partnerships or other pass-through entities.

Vermont Formal Ruling No. 88-18 (January 6, 1989)

You have requested a formal ruling on the application of Vermont's tax laws to partnership income earned by a corporation. This letter relies on representations contained in your letter dated [Date].

Corporation A is an Illinois corporation which owns and operates movie theaters within and without Illinois. Corporation A is a 50% general partner in Partnership Z which owns and operates several theaters in the State of Vermont. Corporation A and Partnership Z are unitary in all respects other than ownership.

The question is whether Corporation A's partnership income is to be reported as business or nonbusiness income and further if the income is to be reported as business income by Corporation A, whether this income is apportioned by Corporation A on the basis of its own apportionment factors or whether the apportionment factors of the partnership are also used.

The same questions are asked assuming Corporation A is a limited partner in Partnership Z and does not participate in the management of Partnership Z.

Because a partnership is not a taxable entity, but is rather an aggregate of distinct partners, each partner is considered as directly conducting the business and owning the assets of the partnership in the state. Thus, income and losses flow through to the partners and are reported on the partners' returns. However, the tax character of any item is determined at the partnership level. IRC § 702(b) provides that the character of any item of income, gain, loss, deduction or credit included in a partner's share shall be determined as if such item were realized by the partnership or incurred in the same manner as incurred by the partnership.

Partnership Z owns and operates theaters in Vermont. The partners thereof are deemed to be conducting this business and are therefore within the taxing jurisdiction of the state. The result does not change where Corporation A is a limited partner in Partnership Z. In either case, the partnership is merely a conduit for business income taxable to the partners.

For Vermont income tax purposes, a corporation's apportionable income is its federal taxable income, with certain adjustments not relevant here. 32 V.S.A. §§ 5811(18), 32 V.S.A. §5833. Vermont statutes are otherwise silent as to the treatment of a corporate partner and specifically as to whether the partnership apportionment factors are to be reflected in those of the corporate partner.

A partnership is not a separate tax-paying entity. Partners are required to report their share of each item of partnership income or loss regardless of whether the partnership makes actual distributions to them. IRC Sec. 702(a). Since partnership income (loss), generated by partnership sales, payroll and property, is included in the corporate partner's income, it follows that the partnership apportionment factors should be reflected in the denominator of the corporate partner's apportionment formula. Stated otherwise, each partner is treated as paying its proportionate share of partnership payroll, incurring its share of partnership depreciation and receiving its share of partnership sales, and these items also should be reflected in the partner's apportionment factors. Thus, to the extent that partnership income is reported by the corporation, the partnership's apportionment factors should also be reflected.

Vermont Instructions to Schedule BA-402 (2023)

If this entity holds an interest in a unitary pass-through entity, then the pro-rata share of the passthrough entity’s apportionment factors must be added to Lines 3 through 12. If the pass-through entity is not unitary then the distributed income is reported on

Lines 1A and 1B, and the pro-rata share of pass-through entity's apportionment factors are excluded from Lines 2 through 20.

Virginia

Va. Code Ann. § 58.1-391(B)

> Each item of pass-through entity income, gain, loss or deduction shall have the same character for an owner under this chapter as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for an owner as if realized directly from the source from which realized by the pass-through entity or incurred in the same manner by the pass-through entity.

Va. Code Ann. § 58.1-391(C)

> Where an owner's distributive shares of an item of pass-through entity income, gain, loss or deduction is determined for federal income tax purposes by special provision in the pass-through entity agreement with respect to such item, and where the principal purpose of such provision is the avoidance or evasion of tax under this chapter, the owner's distributive share of such item, and any modification required with respect thereto, shall be determined as if the pass-through entity agreement made no special provision with respect to such item.

Virginia Ruling of the Commissioner PD 15-240 (April 26, 2007)

> If the entire business of a pass-through entity is not deemed to have been transacted or conducted within the Commonwealth, then "income from Virginia sources" means that portion of the pass-through entity's income that has been allocated and apportioned to Virginia in the same manner as corporations.

Virginia Ruling of the Commissioner PD 07-50 (April 26, 2007)

> A partnership (the "Partnership"), located in ***** (State A), has two 50% equity partners. The general partner is an individual who resides in ***** (State B). The limited partner is a State B corporation. The partnership purchased commercial property in Virginia under a triple net lease. Neither the partnership nor the partners conduct any other business in Virginia other than the ownership of the Virginia commercial property. You request a ruling as to whether any of the parties are required to file Virginia income tax returns.
>
> Virginia Code § 58.1-392 requires every pass-through entity doing business in Virginia or having income from Virginia sources to file an annual information return with the Department of Taxation setting forth its income and a list of owners, effective for taxable years beginning on or after January 1, 2004. Pursuant to Va. Code § 58.1-302, an entity has income from Virginia sources if it has any income, gain, loss or deduction attributable to the ownership in real property located in Virginia. As such, because the Partnership owns income-producing real property in Virginia, it must file an informational return.
>
> Public Law (P.L.) 86-272, codified at 15 U.S.C. §§ 381-384, prohibits a state from imposing a net income tax where the only contacts with a state are a narrowly defined set of activities constituting solicitation of orders for sales of tangible personal property. The Department also applies P.L. 86-272 to the solicitation of sales of other than tangible personal property. See Public Document (P. D.) 93-75 (3/17/93). The Department limits the scope of P.L. 86-272 to only those activities that constitute solicitation, are ancillary to solicitation, or are de minimis in nature. See Wisconsin Department of

Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). The Partnership's ownership of commercial property in Virginia clearly exceeds the protection provided by P.L. 86-272.

Virginia generally conforms to the federal treatment of partnerships. A partnership, as such, is not subject to income tax. Any income tax arising from the income of the partnership is the liability of the partners. Internal Revenue Code § 702(b) states, "The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share . . . shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership." Each item of pass-through entity income, gain, loss or deduction has the same character for an owner for Virginia income tax purposes as for federal income tax purposes. See Va. Code § 58.1-391 B.

Thus, if a partnership operates a business in Virginia, any item of partnership income, gain, loss, deduction, or credit will retain its Virginia source character no matter how many partnerships it passes through. The pass through of Virginia source income will continue to occur from partnership to partner until the income is passed through to a partner that is a taxable entity.

In the situation you present, the income generated by the commercial property will retain its character as Virginia source income and pass through to both the general and limited partners, which are taxable entities. As such, the general partner will need to file a nonresident Virginia individual income tax return and the limited partner will need to file a Virginia corporate income tax return apportioning income in accordance with Va. Code §§ 58.1,-408 through 58.1-421. See Public Document (P.D.) 88-165 (6/29/88).

This ruling is based on the facts presented as summarized above. Any change in facts or the introduction of new facts may lead to a different result.

The Code of Virginia sections and public document cited are available on-line at www.tax.virginia.gov in the Tax Policy Library section of the Department's web site. If you have any questions regarding this ruling, please contact ***** in the Office of Policy and Administration, Appeals and Rulings, at *****.

Virginia Ruling of the Commissioner PD 19-114 (October 4, 2019)

The Taxpayer was a corporation headquartered and domiciled in ***** (State A) that operated refineries. It owned a 17% interest in ***** (PLLC), a limited liability company treated as a partnership for federal income tax purposes that operated retail stores.

The Taxpayer included the apportionment factors of PLLC in its Virginia corporate income tax calculations and apportioned PLLC's income to Virginia. The Taxpayer subsequently filed amended returns for refund, removing PLLC's apportionment factors and allocating its income outside of Virginia. Under review, the Department denied the refunds because the Taxpayer owned more than 10% of PLLC. The Taxpayer appeals the denial of the refunds, contending that it should be allowed to allocate the income generated by PLLC because its ownership interest was a mere investment.

The Department has previously ruled that a corporation that holds a general partnership interest in a partnership must include its proportionate share of partnership property, payroll and sales in its own factors for purposes of apportioning Virginia taxable income. See Public Document (P.D.) 88-226 (7/12/1988).

In P.D. 95-19 (2/13/1995), the Department expanded this ruling to include a limited partner, unless all of the following tests are met: (1) a corporation holds a limited partnership interest; (2) all general partners are unrelated third parties; (3) the combined

partnership interests held by the corporation and all related parties constitute 10% or less of the profit and capital interest of the limited partnership; and (4) the structure is not a device primarily designed to avoid Virginia taxation of the limited partnership's income. The corporate limited partner in P.D. 95-19 failed the test because the general partner was another corporation in the same affiliated group and the two corporations owned 100% of the partnership interests combined. Accordingly, the Department held that the limited partner in P.D. 95-19 was subject to Virginia income tax even though it had no other connection to Virginia other than its interest in the limited partnership.

The Taxpayer contends that its investment in PLLC was a passive investment in a limited liability company because it held a minority number of seats on PLLC's Board of Managers. In addition, the Taxpayer did not participate in the day-to-say management of PLLC and did not share any of its corporate functions such as marketing, purchasing, accounting and legal. Further, the Taxpayer had no authority to unilaterally bind the limited liability company during the taxable years at issue. The Taxpayer argues that its limited role with PLLC is analogous to a limited partnership interest. As such, it should not be required to apportion PLLC's income in accordance with P.D. 95-19.

Under Treasury Regulations § 301.7701-1 et seq., labeled "check the box" regulations, entities are permitted to choose a federal classification or be classified under the regulation's default provisions. If a limited liability company elects to be treated as a pass-through entity for federal income tax purposes, it is required to file a partnership return pursuant to IRC § 761.

A limited liability company, however, is different from a partnership. It shares characteristics of both partnerships and corporations. Like a partnership, a limited liability company is deemed to be a pass through entity that passes its profits and losses through to its members. Unlike a partnership, a limited liability company is a separate legal entity, distinct from its members and has full powers to conduct business in its own name. Limited liability companies are created by statute while partnerships are created by common law. As a legal entity separate from its members, a limited liability company will generally be considered to be operating as a business. Therefore, a limited liability company that passes through its income to its members is merely electing to have its business income taxed in a different manner.

A limited liability company can be managed by its members or by a manager designated by its members. The Taxpayer appears to assert that PLLC is managed by other members or by a management team, and its interest should be treated as if it was a limited partner. The United States Tax Court has distinguished between manager members and other members of LLCs, but defers to state law to distinguish between limited liability companies and partnerships. See Paul D. Garnett, et ux. v. Commissioner, 132 TC 368 (2009). Thus, the mere fact that PLLC files federal partnership returns does not automatically make the Taxpayer a limited partner eligible for treatment under P.D. 95-19.

Pursuant to Virginia Code § 13.1-1022 A, the management of a limited liability company in Virginia is vested in its members unless the articles of incorporation or an operating agreement provides for the management by a manager or managers. Limited partners in a limited partnership do not participate in the management of the enterprise unless a partnership agreement grants the right to vote upon business matters. See Virginia Code § 50-73.23 and First Union Nat'l Bank v. Allen Lorey Family L.P. 34 Va. Cir 474 (1994).

In Virginia, members of a limited liability company run by a manager are similar to limited partners in that they have a restricted role in the conduct of the limited liability company's business. Limited liability company managing members have a fiduciary duty to act in good faith to the limited liability company, but not to the other members. See Credit Experts, LLC v. Santos (In re Santos), 2012 Bankr. LEXIS 3076 (Bankr. E.D. Va. 2012).

Under Virginia Code § 50-73.29 A, a general partner of a limited partner has the same rights and powers of a partner in a partnership without limited partners. In addition to the fiduciary duties a general partner owes to a partnership, they are also responsible for the duty of loyalty and care to other partners, whether limited or not. See Virginia Code § 50-73.102

As a result of the differences under Virginia law, the Department has concluded that, although limited liability companies are treated as partnerships for purposes of determining federal adjusted gross income, the election to have the income passed through to its members more closely resembles the treatment of shareholders in an S corporation. See P.D. 07-70 (5/18/2007). As such, the Department does not distinguish between members of a member managed limited liability company and a manager managed limited liability company.

For federal income tax purposes, attributes and activities of the PLLC will flow through to the Taxpayer. Further, the Department considers a taxpayer to be the owner of a share of the pass-through entity's assets and liabilities. See P.D. 97-343 (8/28/1997). Virginia Code § 58.1-391 B provides:

Each item of pass-through entity income, gain, loss or deduction shall have the same character for an owner under this chapter as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for an owner as if realized directly from the source from which realized by the pass-through entity or incurred in the same manner by the pass-through entity.

Pass-through entities that have income from activity both within and without Virginia are required to compute their Virginia source income in accordance with the corporate statutory formula set forth in Virginia Code §§ 58.1-408 through 58.1-421. As such, pass-through entities generally must allocate dividends to the state of commercial domicile and apportion all other income. Income is apportioned using a three-factor formula based on the property, payroll and sales within Virginia. See P.D. 88-165 (6/29/1988) and P.D. 07-150 (9/21/2007). Therefore, the Taxpayer will include income or loss of PLLC in determining Virginia taxable income and the appropriate amount of PLLC's property, payroll and sales in determining income apportioned to Virginia.

Alternative Method of Apportionment

If the entire business of the pass-through entity is not deemed to have been transacted or conducted within Virginia, then such pass-through entity's income from Virginia sources is the portion of income allocated and apportioned to Virginia in the same manner as corporations. See P.D. 07-150 (9/21/2007).

Accordingly, LLCs that have income subject to tax in Virginia and at least one other state are required to apportion income as provided in Virginia Code §§ 58.1-408 through 58.1-421. The Code of Virginia does not provide for the allocation of income other than certain dividends. Accordingly, a taxpayer's entire federal taxable income, adjusted and modified as provided in Virginia Code §§ 58.1-402 and 58.1-403, less dividends allocable pursuant to Virginia Code § 58.1-407, is subject to apportionment. The Taxpayer's protest has been treated as a request for an alternative method of allocation and apportionment in accordance with Virginia Code § 58.1-421.

In any proceeding with the Department, the Taxpayer bears the burden of showing that the imposition of Virginia's statute is in violation of the standards enunciated by the United States Supreme Court in Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768, 119 L.Ed.2d 533 (1992) and clarified in Meadwestvaco Corporation v. Illinois Department of Revenue, 553 U.S. 16, 128 S.Ct. 1498 (2008). In order to meet the

standards set by the United States Supreme Court, a taxpayer must demonstrate that its investments are not operational assets involved in a unitary business.

In considering the existence of a unitary relationship, the United States Supreme Court has focused on three objective factors: (1) functional integration; (2) centralization of management; and (3) economies of scale. See Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); F. W. Woolworth Co. v. Taxation and Revenue Dept. of N.M., 458 U.S. 352 (1982); and Allied-Signal.

The decision of the United States Supreme Court in Allied-Signal also made it clear that the payee and payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. In Meadwestvaco supra at 29, 128 S.Ct. 1507, the Supreme Court clarified that the decision in Allied-Signal did not create "a new ground for the constitutional apportionment of extrastate values in the absence of a unitary business." Still, it opined the operational function analysis in Allied-Signal could be influential to the finding that an asset was a unitary part of a business being conducted in the taxing jurisdiction. Accordingly, the form of an entity's business and the purpose of its investments are both relevant in determining if an asset was a unitary part of the business conducted by such entity.

As indicated above, Virginia Code § 58.1-391 B provides "[e]ach item of pass-through entity income, gain, loss or deduction shall have the same character for a partner under this chapter as for federal income tax purposes." For Virginia income tax purposes, income retains its character as income from the operations of a pass-through entity in computing Virginia taxable income and is properly included in the apportionable income of the shareholder. This means that, for income tax purposes, the owners are considered to be reporting the operating income of the business conducted by the pass-through entity. As such, the Department generally presumes that the income passed through from a pass-through entity to be operational. See P.D. 07-197 (11/30/2007).

The Taxpayer contends that P.D. 93-140 (6/4/1993) and 7-Eleven, Inc. f/k/a the Southland Corporation v. Comptroller of the Treasury, Court of Special Appeals of Maryland, No. 1661 (6/13/2001) are applicable to its case. Both P.D. 93-140 and Southland Corporation can be distinguished from the Taxpayer's facts because the income at issue resulted from the sale of assets. In this case, the Taxpayer received income from the operations of PLLC, not from the sale of its interest in PLLC.

In P.D. 07-197, the income generated by investments in stocks, bonds, and limited partnership interests made by a partnership formed by a group of corporate taxpayers was considered an investment, rather than operational income. The Department's rationale is that the assets and income of the partnership were not used to supplement or enhance the operations of the group. In P.D. 07-118 (7/19/2007), however, a pass-through entity that was a member of another pass-through entity that operated a hotel was required to include the hotel's apportionment factors in its Virginia taxable income. The Department determined that the characteristics as an operator of the hotel would flow through to the Taxpayer.

In P.D. 07-197, the income was generated by passive investments in stocks, bonds and limited liability companies whereas in P.D. 07-118, the investment was in a pass-through entity that actually operated a business. In this case, PLLC operates a retail business. Therefore, the characteristics of the operator of the retail business would flow through to the Taxpayer. Because it is considered to be operating a retail business for income tax purposes, PLLC is considered to be a unitary part of the Taxpayer's business.

CONCLUSION

Because the Taxpayer's interest in PLLC was greater than 17%, its interest in PLLC does not qualify for the factor exclusion permitted by PD 95-19. In addition, the Taxpayer has not demonstrated that its ownership interest in PLLC was not a unitary part of its business operations. Because it has failed to provide clear and convincing evidence that an alternative method of allocation and apportionment is appropriate, the Taxpayer's request for a refund for the taxable years ended December 31, 2013 through 2015 is not granted.

The Code of Virginia sections and public documents cited are available on-line at www.tax.virginia.gov in the Laws, Rules & Decisions section of the Department's web site. If you have any questions regarding this determination, you may contact ***** in the Office of Tax Policy, Appeals and Rulings, at *****.

The Virginia Form 502 Instructions (2023)

If a PTE's entire business is conducted within Virginia, then all of its income is Virginia source income; no income is allocated to another state, and the entity's Virginia apportionment is 100%. If a PTE conducts its business in Virginia and elsewhere in a manner such that its income would be subject to a tax on net income in Virginia and at least one other state, the entity must allocate and apportion its income in the same manner that is provided in Virginia law for corporations. This applies to all types of pass-through entities (partnerships, LLPs, LLCs, and S corporations). Dividends received are to be allocated to the state of commercial domicile, but all other income must be apportioned. An entity may not apportion its income based on divisional or separate accounting, or any other alternate method unless it has requested and received permission to do so in advance from the Department.

The effect of the PTE's apportionment may vary from one owner to another, depending on the entity types of the owners. For instance:

- a Virginia resident individual owner is taxable on all of his or her PTE income regardless of the entity's apportionment;
- a nonresident individual owner uses the entity's Virginia apportioned income in determining his or her own Virginia nonresident percentage; and
- a corporate owner may need to include the PTE's property, payroll, and sales factors in determining its own apportionment percentage.

Virginia Public Document Ruling No. 88-161 (06/27/1998)

If a Virginia modification is related to an item specially allocated by the partnership agreement, then the partner's distributive share of the Virginia modification shall be the same as the partner's distributive share for federal income tax purposes of the item to which the modification relates.

Virginia Public Document Ruling No. 94-285 (09/20/1994)

Neither the special allocations provisions of the Partnership's partnership agreement nor the manner in which the Corporation reports the percentage of tax-exempt income to its shareholders may operate in such a manner as to shift tax-exempt income among taxpayers solely for the purpose of reducing Virginia income taxes.

West Virginia

W. Va. Code § 11-21-17(b)

Each item of partnership income, gain, loss, or deduction shall have the same character for a partner under this article as for federal income tax purposes. Where an item is not

characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

W. Va. Code § 11-21-17(c)

West Virginia tax avoidance or evasion. — Where a partner's distributive share of an item of partnership income, gain, loss or deduction is determined for federal income tax purposes by special provision in the partnership agreement with respect to such item, and where the principal purpose of such provision is the avoidance or evasion of tax under this article, the partner's distributive share of such item, and any modification required with respect thereto shall be determined as if the partnership agreement made no special provision with respect to such item.

W. Va. Code § 11-21-37

(a) In determining West Virginia source income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with West Virginia sources of such partner's distributive share, for federal income tax purposes, of items of partnership income, gain, loss and deduction, as such portion shall be determined under regulations of the tax commissioner consistent with the applicable rules of section thirty-two [§ 11-21-32].

(b) Special rules as to West Virginia sources. -- In determining the sources of a nonresident partner's income, no effect shall be given to a provision of the partnership agreement which:

(1) Characterizes payments to the partner as being for services or for the use of capital; or

(2) Allocates to the partner, as income or gain from sources outside West Virginia, a greater proportion of his or her distributive share of partnership income or gain than the ratio of partnership income or gain from sources outside West Virginia to partnership income or gain from all sources, except as authorized in subsection (d); or

(3) Allocates to the partner a greater proportion of a partnership item of loss or deduction connected with West Virginia sources than his or her proportionate share, for federal income tax purposes, of partnership loss or deduction generally, except as authorized in subsection (c).

(c) Alternative methods. -- The Tax Commissioner may, on written application filed on or before the due date of the partner's or S corporation shareholder's return under this article for that taxable year determined without regard to any extension of time for filing, authorize the use of such other method or methods of determining the nonresident partner's portion of partnership items, or the nonresident S corporation shareholder's portion of S corporation items, derived from or connected with West Virginia sources, and the modifications related thereto, as may be appropriate and equitable, on such terms and conditions as the commissioner may require.

(d) Application of rules for resident partners to nonresident partners and shareholders.

(1) For a partner's distributive share of items, see subsection (a) of section seventeen of this article.

(2) The character of partnership items for a nonresident partner shall be determined under subsection (b) of section seventeen of this article.

(3) The effect of a special provision in a partnership agreement, other than a provision referred to in subsection (b) of this section, having the principal purpose of avoidance

or evasion of tax under this article shall be determined under subsection (c) of section seventeen of this article.

W. Va. Code § 11-21-37A

(a) Notwithstanding any provision of §11-21-37 of this code to the contrary, a business doing business in West Virginia and in one or more other states shall allocate its non-business income as provided in §11-21-37a(c) of this code and shall apportion its business income as provided in §11-21-37a(f) of this code to determine the West Virginia source income of its nonresident partners and nonresident S corporation shareholders for purposes of this article. For purposes of this section:

(1) The term "business entity" includes a partnership, limited partnership, joint venture, corporation, S corporation, and any other group or combination acting as a unit, but does not include a sole proprietorship; and

(2) The term "engaging in business" or "doing business" means any activity of a business entity which enjoys the benefits and protection of government and laws in this state. . . .

(j)(A) Allocation and apportionment on and after January 1, 2022. - For tax years beginning on and after January 1, 2022, income of flow-through entities allocated and apportioned under this section and §11-21-32 of this code, shall be allocated and apportioned in the same manner and to the same extent as the income of corporations and entities taxable under §11-24-1 et seq. of this code are allocated and apportioned under §11-24-7 of this code. Apportioned income shall be apportioned pursuant to application of a single sales factor to the same extent as the income of corporations and entities taxable under §11-24-1 et seq. of this code are apportioned under §11-24-7 of this code. Allocated income shall be allocated in the same manner and to the same extent as the income of corporations and entities taxable under §11-24-1 et seq. of this code are apportioned under §11-24-7 of this code.

(B) For purposes of this article the provisions of §11-21-12K, §11-21-37b and §11-21-37c of this code remain unchanged by this section.

(C) For purposes of this article, "flow-through entity", "conduit entity" or "pass through entity" means an S corporation, partnership, limited partnership, limited liability partnership, or limited liability company. The term "flow-through entity," "conduit entity" or "pass through entity" includes a publicly traded partnership as that term is defined in section 7704 of the Internal Revenue Code that has equity securities registered with the Securities and Exchange Commission under Section 12 of Title I of the Securities Exchange Act of 1934, 15 USC 78l .

(D) Allocation of flow-through income to recipients. - Income of a flow-through entity allocated and apportioned under this section or any other provision of this article is allocated income in the hands of a shareholder, interest owner, partner, member or other recipient of flow-through income, and taxable to such recipient as income allocated to this state under the provisions of this article, or in the case of recipients of such flow through income that are taxable under the provisions of §11-24-1 et seq. of this code, such income is taxable to such recipient as income allocated to this state under the provisions of §11-24-1 et seq. of this code.

W. Va. Code § 11-24-7(d)(5)

(A) Persons carrying on business as partners in a partnership, as defined in Section 761 of the Internal Revenue Code of 1986, as amended, are liable for income tax only in their separate or individual capacities.

(B) A corporate partner's distributive share of income, gain, loss, deduction or credit of a partnership shall be modified as provided in section six of this article for each partnership. For taxable years beginning on or after December 31, 1998, the distributive share shall then be allocated and apportioned as provided in this section using the partnership's property, payroll and sales factors. The sum of that portion of the distributive share allocated and apportioned to this state shall then be treated as distributive share allocated to this state; and that portion of distributive share allocated or apportioned outside this state shall be treated as distributive share allocated outside this state, unless the taxpayer requests or the Tax Commissioner, under subsection (h) of this section requires that the distributive share be treated differently.

(C) This subdivision shall be null and void and of no force or effect for tax years beginning on or after January 1, 2009.

W. Va. Code § 11-24-13C

(c)(2) The property, payroll and sales of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group in accordance with section thirteen-d of this article and the denominator of which is the amount of the partnership's total unitary income.

W. Va. Code R. § 110-24-6 Example 3

When a partnership owned in part by a corporation has taxable nexus in one or more states into which the corporation sells tangible personal property, but the corporation does not otherwise have taxable nexus with those states. A combined group engaged in unitary business activity consists of Corporations A, B, C and D. The combined group makes sales to customers in States 1, 2, 3, 4, 5 and 6. However, Corporations A and C do not sell tangible personal property to customers in all of those states or, in some of the states, Corporations A and C are not subject to an income tax because of application of Public Law 86-272. Corporations A and C each own an interest in partnerships engaged in unitary business activity with the combined group. These partnerships have taxable nexus with states into which Corporations A and C sell tangible personal property and in which Corporations A and C do not have taxable nexus if their partnership interests are disregarded. Each corporation's share of sales reflected in the apportionment factors of the partnerships are included in the apportionment factors of Corporation A and C, which are the corporate owners of the partnerships. As a consequence, all members of the combined group have taxable nexus with all of the states into which they sell tangible personal property, and the no throw does not apply to this combined group.

West Virginia Form PTE-100 Instructions

Pass through entity owners of pass through entities should allocate income received from a Pass Through Entity unless such entities are engaged in a unitary business. If a unitary relationship exists, a Pass Through Entity owner of a pass through entity may reapportion its WV income, including the appropriate factors of the subsidiary.

West Virginia Taxpayer Services Division Publications No. TSD-392 (May 1, 2020)

A corporate partner's distributive share of partnership income, gain, loss, deduction or credit is apportionable to West Virginia. State law presumes that a corporate partner's distributive share of partnership income is apportionable business income.

West Virginia Taxpayer Services Division Publications No. TSD-423 (11/01/2011)

West Virginia Business Franchise Tax - If the nonresident law firm is a corporation or partnership, the law firm would be liable for the West Virginia business franchise tax.

The amount of tax payable would be calculated based upon the apportioned capital base of the firm. W. Va. Code § 11-23. Apportionment is typically based upon the West Virginia four factor formula consisting of a property factor, a payroll factor and a double weighted sales factor. However, should it appear that the statutory apportionment method does not accurately reflect the extent of the business activity in West Virginia, the Tax Commissioner may require use of, or the taxpayer may petition for, an alternative apportionment method.

Should the nonresident law firm wish to do so, the firm could apply to the West Virginia State Tax Department for use specific accounting to apportion its tax base to the State of West Virginia instead of the typically applied four factor formula. The taxpayer would be required to apply for authorization to use specific accounting to apportion its tax base before the unextended due date of the annual franchise tax return for the tax year for which West Virginia reporting is required.

Wisconsin

Published Guidance:

- Wisconsin Schedule 3K-1 Instructions (2023)

  Excerpt, pages 8 and 9:

  Determining the Wisconsin Income of Nonresident Partners

  Apportionable Income:

  A partnership that is engaged in a unitary business in Wisconsin and at least one other state or foreign country (known as "nexus") must determine the amount of income/loss attributable to Wisconsin for purposes of figuring the share of partnership income/loss taxable to partners that are nonresident or part-year resident individuals or fiduciaries. See sec. Tax 2.82, Wis. Adm. Code, to determine what constitutes nexus and sec. Tax 2.62, Wis. Adm. Code, for a description of what constitutes a unitary business.

  All business income of a partnership is apportionable income, except as provided in the section below titled, *Income Not Subject to Apportionment Formula*. All apportionable business income is taxable to nonresident partners based on the apportionment formula regardless of whether the nonresident partner performs services in Wisconsin.

  The Wisconsin source amount in column (e) is the amount from column (d) multiplied by the partnership's apportionment percentage from the Wisconsin apportionment Schedules A-01 through A-11. Include this schedule when filing Form 3, *Wisconsin Partnership Return*.

  Income Not Subject to Apportionment Formula:

  For items of business income not subject to apportionment under sec. 71.04(4), Wis. Stats., a nonresident partner's distributive share of partnership income from the following sources is attributable to Wisconsin as described below:

  - Income derived from rentals and royalties from business or nonbusiness real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of business or nonbusiness real property or tangible personal property, are allocated to the location of the property from which derived.
  - Intangible income such as interest and dividends, and gains and losses resulting from the sale of intangible property such as stocks, bonds, and securities which are passed through to nonresident partners aren't taxable by Wisconsin because

the income follows the residence of the individual.

- All income that is realized from the sale of or purchase and subsequent sale or redemption of lottery prizes if the winning tickets were originally bought in Wisconsin are allocated to Wisconsin.
- Income derived from casinos, bingo halls, and pari-mutuel winnings in Wisconsin are allocated to Wisconsin.
- Income derived from a covenant not to compete is taxable to the extent that the covenant was based on a Wisconsin based activity.
- Partnership income derived from personal services, including income from professions, follow the location of the services:
    - Partnership income derived from personal services, including professional services, is taxable to a nonresident partner only if the nonresident partner personally performs services in Wisconsin. The amount of personal service income attributable to the nonresident partner's services performed in Wisconsin is taxable.
    - If the partnership derives its income from personal services, a nonresident partner's Wisconsin source amount in column (e) is equal to the value of the services the partner personally performed in Wisconsin. If the nonresident partner didn't personally perform any services in Wisconsin, the Wisconsin source amount in column (e) for that partner is zero. If a partnership derives business income from services other than personal and professional services, nonresident partners must apportion their distributive share of such income to Wisconsin using the partnership's apportionment formula.

The Wisconsin source amount of column (d) is determined similarly for general partners and limited partners. The following examples illustrate the rules described above:

Example 1: Two nonresident individuals are partners of a partnership that does business only in Wisconsin. Both nonresidents are taxed on their entire share of the partnership income for Wisconsin income tax purposes.

Example 2: A nonresident is one of two equal partners of a partnership that does business in Wisconsin and Illinois. Using the apportionment formula, the partnership derives 40% of its income from business activities in Wisconsin. The Wisconsin resident is taxed on one-half of the total partnership income for Wisconsin income tax purposes. The nonresident is taxed on one-half of the 40% of the partnership income attributable to business activities in Wisconsin.

Example 3: A nonresident is a limited partner, with a 1% interest in partnership profits, of a partnership that derives income from real estate located in Wisconsin and in other states. The nonresident limited partner is taxed on 1% of the partnership income attributable to the real estate located in Wisconsin.

Example 4: A nonresident is a partner, with a 10% interest in partnership profits, of a certified public accounting firm that operates in and outside Wisconsin. One-fourth of the partnership's income is attributable to professional services performed in Wisconsin and three-fourths is attributable to professional services performed in other states. The nonresident partner doesn't personally perform any services in Wisconsin. The nonresident isn't subject to Wisconsin income tax on their proportionate share of the partnership

income earned in Wisconsin.

- A partnership engaged in a nonunitary business (one in which the operations in Wisconsin are not dependent upon or contributory to the operations outside Wisconsin) in and outside Wisconsin must determine the amount of income attributable to Wisconsin by separate accounting. Under separate accounting, the partnership must keep separate records of the sales, cost of sales, and expenses for the Wisconsin business. Use Form C, *Wisconsin Allocation and Separate Accounting Data*, to compute the income allocable in and outside Wisconsin. Include the schedule when filing Form 3, *Wisconsin Partnership Return*.
  - Except for nonunitary income, and except for income/loss items not requiring apportionment as explained above, a unitary business may use separate accounting only with the approval of the department. A request for approval must set forth in detail the reasons why separate accounting will more clearly reflect the partnership's Wisconsin net income. It should be mailed to the Wisconsin Department of Revenue, Mail Stop 3-107, PO Box 8906, Madison, WI 53708-8906 before the end of the taxable year for which the use of separate accounting is desired.

Excerpt, page 17:

Part IV – Partner's Share of Apportionment Factors:

Partnerships, corporations, and tax-option (S) corporations must generally include their share of the numerator and denominator of the partnership's apportionment factors in the numerator and denominator of their apportionment factors, even if the election to pay tax at the entity level was made. Include these amounts using the Wisconsin apportionment Schedules A-01 through A-11, as appropriate. For a corporation or an- other partnership that is a partner, enter on line 25 or lines 26 through 28 the partner's proportionate share of the partnership's apportionment factors from the Wisconsin apportionment Schedule A-01 through A-11 (if applicable).

- Wisconsin Tax Bulletin No. 197 (April 2017), page 4

Apportionment for Partnerships and Partners

A partnership engaged in a unitary business both in and outside Wisconsin is a "multi-state partnership". A multi-state partnership will generally use Form A-1, *Wisconsin Apportionment Data for Single Factor Formulas*, or Form A-2, *Wisconsin Apportionment Data for Multiple Factor Formulas*, to determine the portion of income attributable to Wisconsin.

The information the partnership provides to a partner on Schedule 3K-1, Partner's Share of Income, Deductions, Credits, etc., to report their share of income depends on the type of partner:

A. Individual: A partner that is a nonresident individual reports his or her share of the partnership income after apportionment. The partnership reports this "Wis. source amount" in column (e) on Schedule 3K-1.

B. C-Corporation: A partner that is a C-Corporation reports its share of income, before apportionment, from the partnership. The partnership reports this amount in column (d), "Amount under Wis. law", of Schedule 3K-1. The partnership must also report the corporation's share of the partnership's apportionment factors in Part IV of Schedule 3K-1, Partner's Share of Apportionment Factors. The corporation combines the amounts from Part IV with its own apportionment factors on its Form A-1 or Form A- 2.

C. Partnership or Tax-Option (S) Corporation: A partner that is a partnership or tax-

> option (S) corporation reports its share of income, before apportionment, from the partnership. The partnership reports this amount in column (d), "Amount under Wis. law", of Schedule 3K-1. The partnership must also report the partner's share of the partnership's apportionment factors in Part IV of Schedule 3K-1, Partner's Share of Apportionment Factors. The partnership or tax-option (S) corporation partner combines the amounts from Part IV with its own apportionment factors on its Form A-1 or Form A- 2.

See full article for an example.

- Wisconsin Tax Bulletin No. 208 (2023)

Wisconsin Sourced Income of Multi-Tiered Partnership Electing to Pay Tax at Entity Level

A partnership that makes the election to pay tax at the entity level for Wisconsin under sec. 71.21(6)(a), Wis. Stats., must determine income, loss and deductions attributable to Wisconsin pursuant to sec. 71.04, 71.14, 71.25, 71.362, or 71.45, Wis. Stats., as if the election was not made.

If the electing partnership is part of a multi-tiered entity structure (i.e., another partnership owns a percentage of the capital and profits of the electing partnership), the electing partnership must look through all the tiers of the multi-tiered entity to determine income, loss and deductions attributable to Wisconsin. For additional detail, see example 2 under Column (c) of the Schedule 3-ET Instructions.

- Wisconsin Tax Bulletin No. 209 (April 2020), page 11

Apportionment – Allocating Partnership Sales to Corporate Partners Who are Members of a Combined Group

A partnership engaged in a unitary business both in and outside Wisconsin is a "multistate partnership". To determine the portion of income attributable to Wisconsin, a multistate partnership will generally use Schedule A-01, *Wisconsin Single Sales Factor Apportionment Data for Nonspecialized Industries*, unless one of the industry specific Schedules A-02 through A-11 apply. For additional information on computing apportionment for partnerships and partners, see Wisconsin Tax Bulletin 197 (April 2017).

A multistate partnership must provide each corporate partner a Schedule 3K-1, *Partner's Share of Income, Deductions, Credits, etc.*, and complete Part IV, *Partner's Share of Apportionment Factors*. Part IV of Schedule 3K-1 must include the corporate partner's distributive share of both Wisconsin gross sales and total company gross sales.

Corporations, including members of combined groups, add their distributive share of the partnership's gross sales (from Schedule 3K-1, Part IV) to their own gross sales and report the amounts on their own apportionment schedule (e.g., Schedule A-01).

See full article for an example illustrating the computation and reporting for corporate partners that are members of a combined group (secs. 71.20(1m) and 71.255(5)(a)6, Wis. Stats., and sec. Tax 2.61(7)e, Wis. Adm. Code)

- Wisconsin Schedule A-01 Instructions (2023)

Excerpt, page 1:

Corporations, partnerships, tax-option (S) corporations and nonresident estates, trusts, and individuals that are engaged in a unitary business both in and outside Wisconsin generally use Schedule A-01 to compute the factors that will determine their Wisconsin

share of income from a unitary business.

Excerpt, page 2:

Partnerships, corporations, and tax-option (S) corporations must generally include their share of the numerator and denominator of a partnership's apportionment factors in the numerator and denominator of their apportionment factors. Include these amounts using the Wisconsin apportionment Schedules A-01 through A-11, as appropriate.

Excerpt, page 5:

Sales to Pass-Through Entities Owned by Combined Group Members. If a combined group member makes a sale to a pass-through entity which is more than 50 percent owned, directly or indirectly, by members of the combined group, the member must eliminate an amount equal to the gross receipts of the sale multiplied by the sum of all combined group members' interests in the pass-through entity as of the date of the sale.

Excerpt, page 6:

Sales by Pass-Through Entities Owned by Combined Group Members. If a pass-through entity makes a sale to a combined group member and more than 50 percent of the pass- through entity is directly or indirectly owned by members of the combined group, each member with an interest in the pass-through entity must subtract from its sales factor numerator and denominator any amount that would otherwise be included attributable to the sale.

- Pass-Through Entity-Level Tax: Partnership Determining Income and Computing Tax common questions

  See common question number one, *How does an electing partnership determine the situs of income?*

- Pass-Through Entity Withholding common questions

  Common question number 16, *What happens when a pass-through entity is in a "tiered" structure, where it owns another pass-through entity?*

  If a pass-through entity (called an "upper-tier entity") owns another pass-through entity (called a "lower-tier" entity), the lower-tier entity is required to withhold on the Wisconsin income allocable to the upper-tier entity. The upper-tier entity may then take credit for tax already withheld by the lower-tier entity when it withholds on behalf of its own nonresident members.

  Alternatively, the upper-tier entity may file an exemption affidavit (Form PW-2) to elect out of withholding from the lower-tier entity. In this case, the upper-tier entity would pay the withholding on its total Wisconsin income allocable to its nonresident members even if that income is from the lower-tier entity.

Statutory References:

- Wis. Stat. § 71.04 *Situs of income; allocation and apportionment.* (individuals, estates, and trusts)
- Wis. Stat. § 71.14 *Situs of income.* (estates and trusts)
- Wis. Stat. § 71.21(6)(d)1. *Situs of income.* (partnerships electing to pay tax at the entity level)
- Wis. Stat. § 71.25 *Situs of income; allocation and apportionment.* (corporations)

- Wis. Stat. § 71.255(1)(n) *Combined reporting. Unitary business.* (combined reporting of pass-through entities owned directly or indirectly by a corporation)
- Wis. Stat. § 71.255(5)(a)6. *Member's share of business income of the combined group.* (combined reporting of pass-through entities owned directly or indirectly by a corporation)
- Wis. Stat. § 71.362 *Situs of income.* (tax-option (S) corporations)
- Wis. Stat. § 71.775 *Withholding from nonresident members of pass-through entities.*

Administrative Code References:

- Wis. Adm. Code Tax § 2.39 *Apportionment method.*
- Wis. Adm. Code Tax § 2.41 *Separate accounting method.*
- Wis. Adm. Code Tax § 2.61(7)(e) *Combined reporting. Pass-through entities.*
- Wis. Adm. Code Tax § 2.62(7) *Unitary business. Passive holding companies.*
- Wis. Adm. Code Tax § 2.62(8) *Unitary business. Pass-through entities.*

Wis. Stat. § 71.04(3)(c)

> In computing taxes under this chapter a partner or member shall disregard, for purposes of determining the situs of partnership income of partners, all provisions in partnership or limited liability company agreements that do any of the following:
>
> 1. Characterize the consideration for payments to the partner or member as services or the use of capital.
> 2. Allocate to the partner or member, as income from or gain from sources outside this state, a greater proportion of the partner's or member's distributive share of partnership or limited liability company income or gain than the ratio of partnership or company income or gain from sources outside this state to partnership or company income or gain from all sources.
> 3. Allocate to a partner or member a greater proportion of a partnership or limited liability company item of loss or deduction from sources in this state than the partner's or member's proportionate share of total partnership or company loss or deduction.
> 4. Determine a partner's or member's distributive share of an item of partnership or limited liability company income, gain, loss or deduction for federal income tax purposes if the principal purpose of that determination is to avoid or evade the tax under this chapter.

McQuide v. Wisconsin Department of Revenue, Wisconsin Tax Appeals Commission, Case No. 93-I-532; 93-I-632-SC; 94-I-171 (December 12, 1995).

> In light of the foregoing, it is clear that the special allocations of paragraph 10 lacked economic effect under Treas. Reg. § 1.704-1(b)(2)(ii)(a), because the allocation was inconsistent with the underlying economic arrangement of the Mascaris and McQuides, and no downward adjustments were ever made to the capital account of the McQuides to reflect those deductions which were specially allocable to them. Having determined that the special allocations failed the first tier of the test of "substantial economic effect" we need not reach the question of substantiality under Treas. Reg. § 1.704-1(b)(2)(iii).

Wall v. Wisconsin Department of Revenue, Wisconsin Tax Appeals Commission, Case No. 87-I-70 (November 3, 1998).

> Petitioner did not bear the entire economic burden for the losses allocated to him, as is evidenced by the partnership agreement's failure to require liquidation proceeds to be

distributed in accordance with the partners' capital account balances, and capital account deficits to be restored upon liquidation. In addition, the capital contributions made to the partnership by Barbara Wall were not properly reflected in her capital account. Consequently, the loss allocation to petitioner lacked substantial economic effect . . . The respondent properly allocated the partnership losses between Thomas and Barbara Wall on the basis of their interests in the partnership.