



MULTISTATE TAX COMMISSION

State Taxation of Partnerships Update on Developments and White Paper on Sourcing in Complex Structures

SEPTEMBER 18, 2024



NOTE:

THESE SLIDES CONTAIN INFORMATION ON THE ISSUES INVOLVED IN SOURCING PARTNERSHIP INCOME IN COMPLEX PARTNERSHIP STRUCTURES. THIS INFORMATION IS FOR DISCUSSION PURPOSES ONLY.





PARTNERSHIP TAX DEVELOPMENTS



IRS DEVELOPMENTS

BASIS SHIFTING

IRS News Release – June 17, 2024 –

IRS announces new steps to combat abusive use of partnerships; agency’s focus intensifies as new guidance closes loopholes worth tens of billions

<https://www.irs.gov/newsroom/irs-announces-new-steps-to-combat-abusive-use-of-partnerships-agencys-focus-intensifies-as-new-guidance-closes-loopholes-worth-tens-of-billions>

- Explains the need for regulatory guidance for partnerships addressing when basis-adjustments will be allowed in transactions between related parties under IRC §§ 732 and 734. (See Notice 2024-54.)
- “The new guidance is designed to stop the use of “basis shifting” transactions that use related-party partnerships to avoid taxes.”

IRS DEVELOPMENTS

BASIS SHIFTING

IRS News Release – June 17, 2024 (cont'd)

- “. . . basis shifting amounts to a shell game where sophisticated tax maneuvers take place by shifting the basis of assets between **closely related entities**, ultimately allowing these **complex partnership arrangements** to hide from a tax bill,” Commissioner Werfel said. ‘These **complicated maneuvers** take time and resources for the IRS to uncover. The new guidance is aimed at telling promoters that the IRS considers these transactions inappropriate, and we are bringing new Inflation Reduction Act resources into play to beef up our compliance work in the **overlooked partnerships and pass-throughs area.**’”

But then . . . on June 28, 2024, the Supreme Court issued Loper Bright.

IRS DEVELOPMENTS

BASIS SHIFTING

July 17, 2024 – Nat'l Ass'n of Manufacturers filed letter opposing the new rules

- The letter states: “Notice 2024-54 cites as authority for the forthcoming proposed regulations sections 482, 732, 734(b), 743(b), 755, and 7805. While certain of those statutory provisions do contemplate the exercise of a degree of agency discretion in issuing regulations, the forthcoming proposed regulations far exceed it. As the Supreme Court explained in *Loper Bright*, even where statutes provide an express grant of regulatory authority, courts must still “independently interpret the statute and effectuate the intent of Congress subject to constitutional limits.”

OTHER LOPER-BRIGHT DEVELOPMENTS

***Tribune Media Co. v. Commissioner* – Pending at the Seventh Circuit**

- In 2009, Tribune transferred ownership of the Chicago Cubs using a partnership structure.
- As described by the Tax Court: “Tribune sought to arrange its transaction as to minimize its taxes.” (Citing Judge Hand’s ruling in the *Gregory v. Helving* case in the Second Circuit.) The way in which it did this was to take advantage of rules that allow a partner to increase the basis in a partnership interest to the extent of partnership liabilities attributed to the partner. (TC Memo 2021-122)
- IRS determined this attribution of debt was artificial and the transfer was a “disguised sale.” It imputed gain to the Tribune and assessed \$181,662,000 in tax, relying on the general partnership anti-abuse regulation – Treas. Reg. 1.701-2.
- The Tax Court ruled for the IRS but only in part, finding that a portion of the transaction was not taxable under IRC Sec. 707(a)(2)(B) and reduced the tax owed by over half. The case is now on appeal to the Seventh Circuit.
- Question – Can the IRS rely on the general partnership anti-abuse regulation (Reg. 1.701-2).

OTHER LOPER-BRIGHT DEVELOPMENTS

IRS Position (*Tribune Media* – before the Seventh Circuit) –

- The IRS argues: “. . . the partnership anti-abuse rule targeted by petitioners is rooted in well-established caselaw combating tax abuse. Nearly 60 years before §1.701-2 was promulgated, the Supreme Court upheld the Commissioner's determination that a corporate reorganization, which met technical statutory requirements, nonetheless “was without substance and must be disregarded” for federal tax purposes. *Gregory v. Helvering*, 293 U.S. 465, 467-70 (1935). The §1.701-2 anti-abuse rule is directly traceable to *Gregory* and its progeny. And the business-purpose requirement in §1.701-2(a)(1), on which the Commissioner's appeal focuses, also is consistent with Congress's more recent codification of the judicial economic-substance doctrine, I.R.C. §7701(o).

OTHER LITIGATION

***Rawat v. Commissioner*, 108 F.4th 891 (D.C. Cir. 2024)**

- “Aggregate sourcing” – what is it?
 - First - it differs from the attribution principle which says that the character of partnership income, expense, gain, and loss—including their sourcing—is determined at the partnership level and then attributed to the partners who receive a share of those items.
 - The aggregate theory treats partners as having joint ownership of partnership assets. So aggregate sourcing generally refers to the treatment of gains from the sale of a partnership—realized directly by the partner—and looks through to the assets of the partnership to determine the sourcing of any gain (loss).
 - The IRS long applied this approach to sourcing gains on the sale of the partnership interests by foreign partners, effectively treating the gain as if it were attributed to a sale of each of the assets.

OTHER LITIGATION

***Rawat v. Commissioner*, 108 F.4th 891 (D.C. Cir. 2024)**

- In *Grecian Magnesite Mining, Indus. & Shipping Co., SA v. Comm'r*, 926 F.3d 819 (D.C. Cir. 2019), the court ruled that the IRS could not source gains of foreign partners from sales of domestic partnership interests using an “aggregate” approach—looking through to the location of the assets.
- In 2017, TCJA amended IRC Sec. 864 to specify that gains are sourced using an aggregate approach—looking through to the location of the assets of the partnership.

OTHER LITIGATION

***Rawat v. Commissioner*, 108 F.4th 891 (D.C. Cir. 2024)**

- In *Rawat*, the IRS argued that even prior to TCJA, gains from the sale of a partnership interest that are attributed to the partnership’s “hot assets” (e.g., inventory and accounts receivable) should be sourced on an aggregate basis, because IRC Sec.s 741 and 751 provide an exception that treats that portion of gain as “ordinary income.”
- The D.C. Circuit ruled IRC Sec. 751 does not change the sourcing of that portion of the gain, holding in part that IRC Sec. 741 first provides that gains from sales of partnership interests are taxed as gains from sale of a capital asset except for Sec. 751. Since the exception does not apply to the sourcing of the gain, specifically, it is limited to treating the portion of the gain from hot assets as ordinary income.

OTHER DEVELOPMENTS

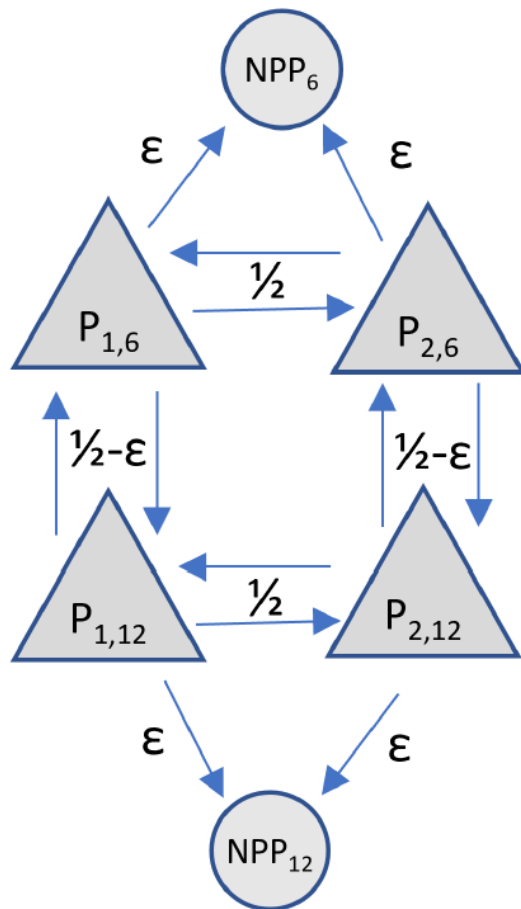
Deferring Income with Tiered and Circular Partnerships

Chris William Sanchirico, Reed Shuldiner, University of Pennsylvania, Institute For Law and Economics, Research Paper 24-28, Aug. 25, 2024

“. . . partnerships can have different taxable years from their partners and that this can result in deferral of taxes. Thus, when at the close of its taxable year a partnership passes income to its partners, some partners' taxable years may just be getting underway. Those partners will not owe tax on their distributive share until after their own taxable year ends months later.

“This opportunity for deferral is ostensibly limited by rules that restrict the partnership's choice of taxable year based on a formulaic aggregation of partners' taxable years. But how effective are these rules? How much deferral do they allow?

“We find that existing restrictions on partnerships' taxable years are far less effective than they may at first appear.”



“By carefully phasing taxable years in tiered and circular partnership structures, taxpayers can indefinitely defer tax with minimum complexity and friction. Existing rules that restrict partnerships’ taxable years are ill-adapted to handle tiering and circularity. Even strengthening such rules to look through tiers of partnerships would do little to temper the deferral opportunity.”

OTHER DEVELOPMENTS

“The past, present, and future of the BBA partnership audit regime”

By Jonathan Williamson, CPA, MT, Cleveland, The Tax Adviser, August 1, 2024

“Partnership complexities are compounded by evolving allocation and liquidation methodologies, tiered structures, and ever-increasing reporting requirements . . . Partnership adjustments are problematic due to the cascading nature of partnerships. A change in income or loss may change how all items of a partnership are allocated to its partners, which may result in changes to upper-tier entities, and so on.”

OTHER DEVELOPMENTS

“Artificial Intelligence May Help IRS Close the Tax Gap”

Government Accountability Office, WatchBlog: Following the Federal Dollar, June 6, 2024

(Here: <https://www.gao.gov/blog/artificial-intelligence-may-help-irs-close-tax-gap>)

- **“Partnership audits.** . . .The number of large partnerships has increased substantially in recent years (by nearly 600% between 2002 and 2019). This shift has made it more difficult for the IRS to identify taxable income and catch potential tax cheats.
- “IRS audits few large partnerships’ tax returns because they are complex. And when IRS does audit them, the result is often no change to the audited return. IRS currently uses two AI models to help prioritize partnership returns for audit. The models are intended to help select the highest risk large partnership returns for audit. But we think more could be done to address design weaknesses that may limit these models’ ability to objectively identify the most high-risk returns and improve audit selection over time.”



**WHAT DOES A GENERATIVE AI (OpenAI ChatGPT 4o)
THINK OF SOURCING IN COMPLEX PARTNERSHIPS?**

DISCLAIMER: JUST FOR FUN (NOT TO RELY)



WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

How should states handle sourcing in tiered partnerships?

Sourcing in tiered partnerships (where one partnership is a partner in another partnership) can be complex because income flows through multiple levels, each subject to its own tax rules. States must determine how income is sourced to ensure the proper amount of tax is collected at each level. Here are the key considerations for states when handling sourcing in tiered partnerships:

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

1. Income Sourcing Rules at Each Partnership Level

- **Direct Partnership Level:** States typically require that income generated by a partnership be sourced to the state where the partnership's business activities occur. This is usually based on factors such as property, payroll, and sales (apportionment).
- **Indirect or Lower-Tier Partnerships:** When a partnership holds interests in another partnership (tiered partnerships), states may apply the same apportionment rules at both the upper and lower-tier partnership levels. The income attributed to the upper-tier partnership is sourced according to the business activities of the lower-tier partnerships.

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

2. Look-Through Approach

- **Tracing Income to Source:** Many states use a "look-through" approach, tracing the income from the lower-tier partnership back to its source. In this method, the state looks at where the lower-tier partnership generates its income (e.g., its state apportionment factors), and then passes that information up to the upper-tier partnership. The upper-tier partnership uses that data to determine the income sourcing for its partners.
- **Distributive Share:** Each partner in the upper-tier partnership must report their share of the lower-tier partnership's income in line with the sourcing rules of the state where the income is sourced. For instance, if a lower-tier partnership has income sourced to multiple states, the upper-tier partner must use that allocation when sourcing income to its own partners.

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

3. **Apportionment Factor Flow-Through**

- **Flow-Through Apportionment:** In tiered structures, apportionment factors from the lower-tier partnership often flow up to the upper-tier partnership. For instance, if the lower-tier partnership operates in multiple states, it will generate an apportionment factor based on property, payroll, and sales in each state. The upper-tier partnership then applies these factors when apportioning its own income.
- **Upper-Tier Responsibility:** The upper-tier partnership is responsible for ensuring that it reports income according to these apportionment factors, considering the operations of the lower-tier partnership. This helps ensure that income from multistate operations is correctly sourced across all states involved.

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

4. Withholding and Composite Filing

- **Withholding Requirements:** States may require partnerships to withhold taxes on behalf of their nonresident partners. In tiered partnerships, the upper-tier partnership may be required to withhold taxes for nonresident partners based on the income sourced to the lower-tier partnership's activities. This ensures that nonresident partners pay their fair share of taxes in the states where the income is sourced.
- **Composite Filing:** Some states allow partnerships to file composite returns on behalf of their nonresident partners. This can simplify the tax filing process for upper-tier partnerships by allowing them to report and pay taxes for all their nonresident partners in a single filing. However, this requires careful tracking of sourcing rules to ensure income is allocated correctly.

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5. State-Specific Variations

- **Differences in Sourcing Rules:** Each state may have slightly different rules on how income from tiered partnerships is sourced. Some states may use an entity-level approach, while others use a partner-level approach to sourcing. States may also vary in how they handle apportionment for multistate businesses.
- **Uniformity Challenges:** Lack of uniformity between states can complicate the sourcing of income in tiered partnerships. For instance, if one state uses market-based sourcing for services while another uses cost-of-performance, the same income may be sourced differently at different levels of the partnership.

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Follow-Up Questions

1. How do withholding requirements vary for upper-tier partnerships across different states?
2. What are the challenges of apportioning income when a tiered partnership operates in multiple states with conflicting sourcing rules?
3. Can a lower-tier partnership's business activities create a tax nexus for partners in the upper-tier partnership?
4. What do you need to improve your latest answer based on the information you have provided?

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

1. Conflicting Sourcing Methods (Market-Based vs. Cost-of-Performance)

- **Market-Based Sourcing:** Some states use market-based sourcing, where income from services or sales is sourced to the location of the customer or where the benefit of the service is received.
- **Cost-of-Performance Sourcing:** Other states use cost-of-performance sourcing, where income is sourced to the state where the greatest portion of the cost of performing the service is incurred.
- **Challenge:** In tiered partnerships, these differences can cause the same income to be sourced to multiple states. For example, a lower-tier partnership in a cost-of-performance state might allocate its income based on where its work is performed, but an upper-tier partnership in a market-based state might need to allocate the same income based on customer location. This creates potential **double taxatio** ↓ conflicting reporting obligations.

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

2. Varying Apportionment Formulas

- **Apportionment Factors:** States generally use different apportionment formulas based on property, payroll, and sales factors to allocate income. These formulas vary widely between states. Some states may place more weight on the sales factor, while others use an equally weighted three-factor formula.
- **Challenge:** For tiered partnerships, the lower-tier partnership's apportionment factors must be passed up to the upper-tier partnership. However, when the upper-tier partnership operates in states that use different apportionment formulas, **it becomes difficult to apply the lower-tier's data consistently**. This complexity can result in **misapplied apportionment percentages** and require significant administrative effort to reconcile the differences across states.

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3. Differences in Treatment of Pass-Through Income

- **Flow-Through Income:** Many states treat partnership income as pass-through, meaning the income flows through to the individual partners and is taxed at the partner level rather than at the partnership level.
- **Entity-Level Taxes:** However, some states impose an entity-level tax on partnerships, in addition to taxing the income passed through to the partners.
- **Challenge:** In tiered partnerships, the upper-tier partnership may need to comply with different tax regimes, where some states apply entity-level taxes and others do not. This can create **duplication of taxation** or differing methods for determining what income is taxable at each level of the partnership, complicating the overall apportionment process.

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4. Nexus and Filing Obligations

- **Nexus Creation:** A lower-tier partnership's business activities in a state may establish a tax nexus for the upper-tier partnership and its partners in that state. Nexus rules vary by state, with some applying economic nexus standards based on sales thresholds, while others require a physical presence.
- **Challenge:** The upper-tier partnership might face tax filing obligations in states where it has no direct physical presence, but where the lower-tier partnership does. This creates **compliance challenges**, as the upper-tier partnership needs to track which states have established nexus based on lower-tier activities. It also increases **administrative burdens** in meeting filing and reporting requirements across states.

WHAT DOES AI THINK OF SOURCING IN COMPLEX PARTNERSHIPS? – *DISCLAIMER: JUST FOR FUN (NOT TO RELY)*

Is state tax sourcing for tiered partnerships simple?

No, state tax sourcing for **tiered partnerships** is far from simple. It involves navigating multiple layers of income flow between partnerships, each of which might operate in different states with varying tax rules, sourcing methods, and apportionment formulas. Each state may use different criteria, such as **market-based** or **cost-of-performance** sourcing, to determine where income should be taxed. This complexity is further compounded by the need to track apportionment data across tiers, comply with different nexus rules, and manage reporting for multiple partners.





UPDATE ON WHITE PAPER



SEE ALSO THE SLIDES FROM JULY 17, 2024 MEETING

- Those July 27th slides provide a general outline of the white paper, including:
 - Scope –
 - Corporate and Tiered Partners
 - Special Allocations
 - Related-Party Transactions
 - Terminology and Concepts
 - Attribution Principle
- All this draws on multistate research.

“HOW” ISSUES

Comparing Three Methods to Determine Share of Factors

- No Blending
- Share of Capital
- Share of Income

Special Allocations

- Different Capital and Income Shares
- Special Allocations of Particular Items
- How to Treat Items of Losses-to-Income and Items of Income-to-Loss

Guaranteed Payments and Intercompany Transactions

- Eliminated from Factors?
- Eliminated from Income?

Necessary Exceptions or Anti-Abuse Rules

TREATMENT OF NON-APPORTIONABLE INCOME/ITEMS

Step 1 – Entity-Level Non-Apportionable Income –

- Determine whether any partnership items are non-apportionable to the entity that recognized or incurred the items.
- If so—they are sourced at the entity level and that sourcing information flows through to direct and indirect partners.

Step 2 – Partner-Level Non-Apportionable Income –

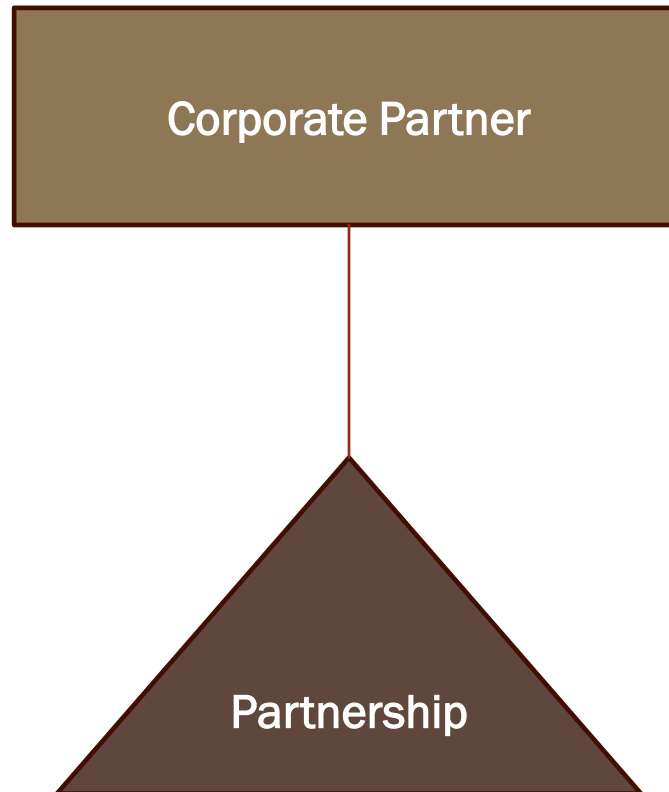
- If the answer to Step 1 is no—that is, the income or items are apportionable income to the partnership—then determine if the partner’s distributive share would, itself, be non-apportionable income to the partner.
- If so, then the income or items are apportioned at the partnership level and that sourcing information flows through to direct and indirect partners.

BLEND ED APPOR TIONMENT

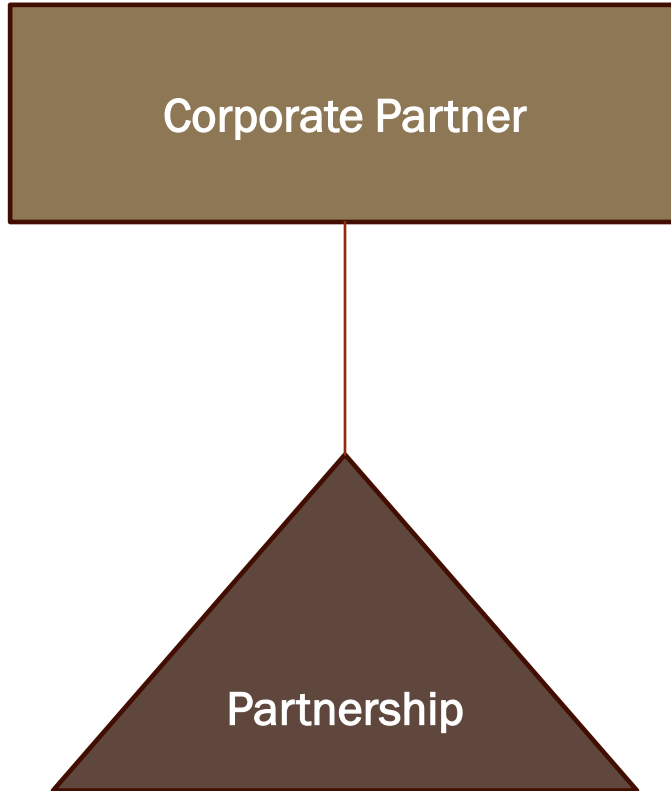
- States use formulary apportionment.
- Default Rule – Use the factors of the entity recognizing the income.
- Blended Apportionment – Some states require a combination of the taxpaying partner factors with a share or the partnership factors for:
 - Corporate partners
 - Tiered structures

But there are lots of “how” questions.

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

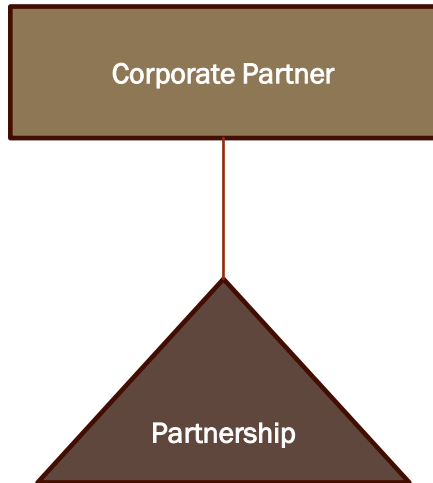


BLENDING APPORTIONMENT – SIMPLE EXAMPLE



- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$100,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere

BLENDING APPORTIONMENT – SIMPLE EXAMPLE



- **Assume:**
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives 80% of Partnership's items of income, expense, gain, and loss.

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Sourcing Approach - **No Blending**

Partnership Income Sourced to State A at Partnership Level (50% x \$100,000)	\$ 50,000
Corporate Partner's Share of State A Income (80% of \$50,000)	\$ 40,000
Corporate Partner's Own Income Sourced to State A (10% of \$100,000)	\$ 10,000
Total Corporate Partner Income Sourced to State A	<u>\$ 50,000</u>

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- Assume:
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Sourcing Approach – Using Share of Partnership Capital to Determine Share of Factors

Corporate Partner's Share of Total Partnership Income (80% of \$100,000)	\$ 80,000			
Corporate Partner's Income	\$ 100,000			
Total Corporate Apportionable Income	<u>\$ 180,000</u>	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (using 80% capital share)		\$ 400,000	\$ 800,000	
Corporate Partner's Own Factors		\$ 200,000	\$ 2,000,000	
Total Corporate Partner's Sales Factor		<u>\$ 600,000</u>	<u>\$ 2,800,000</u>	21%
Corporate Partner's Total Income Sourced to State A	<u>\$ 38,571</u>			

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

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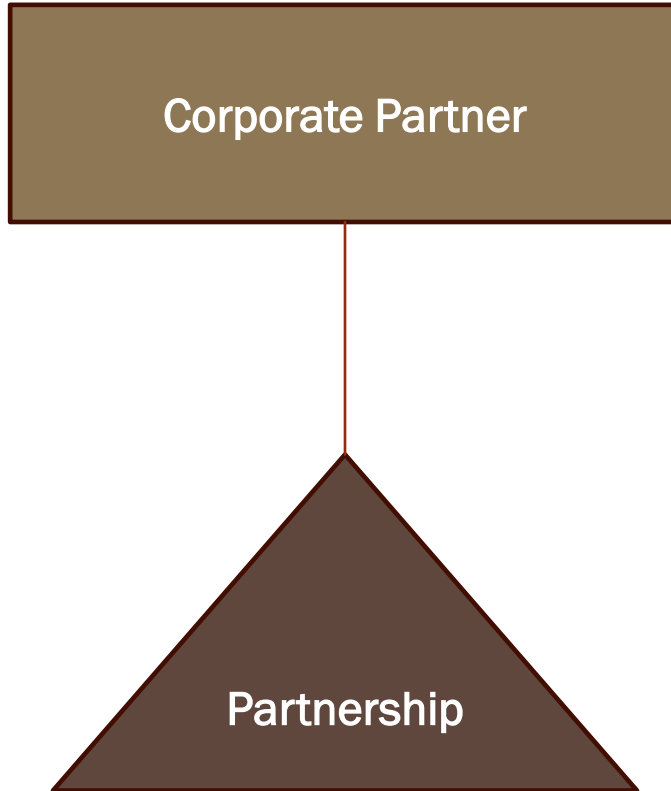
Corporate Partner's Share of Total Partnership Income (80% of \$100,000)	\$ 80,000			
Corporate Partner's Income	\$ 100,000			
Total Corporate Apportionable Income	<u>\$ 180,000</u>	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (using 80% income share)		\$ 400,000	\$ 800,000	
Corporate Partner's Own Factors		\$ 200,000	\$ 2,000,000	
Total Corporate Partner's Sales Factor		<u>\$ 600,000</u>	<u>\$ 2,800,000</u>	21%
Corporate Partner's Total Income Sourced to State A	<u>\$ 38,571</u>			



COMPARISON:

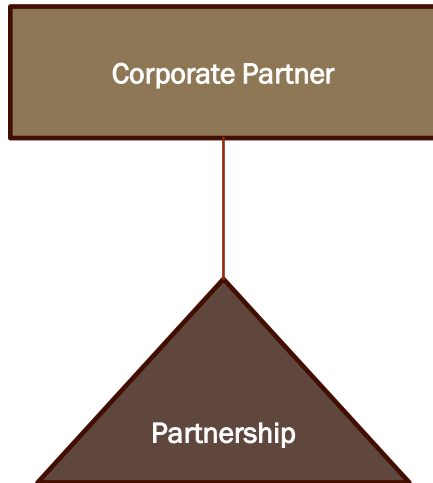
- No Blended - \$50,000
- Using Share of Capital - \$38,571
- Using Share of Income - \$38,571

BLENDING APPORTIONMENT – SIMPLE EXAMPLE



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Sourcing Approach - No Blending

Share of Partnership Loss Sourced to State A (50% X -\$100,000)	\$ (50,000)
Corporate Partner's Share of State A Income (80% of the loss)	\$ (40,000)
Corporate Partner's Own Income Sourced to State A (10% of \$100,000)	\$ 10,000
Total Corporate Partner Income Sourced to State A	<u>\$ (30,000)</u>

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Sourcing Approach – Using Share of Partnership Capital to Determine Share of Factors

Corporate Partner's Share of Loss	\$ (80,000)			
Corporate Partner's Income	\$ 100,000			
Total Apportionable Income of Corporate Partner	\$ 20,000	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (80%)		\$ 400,000	\$ 800,000	
Corporate Partner's Own Factors		\$ 100,000	\$ 1,000,000	
Total Corporate Partner's Sales Factor		\$ 500,000	\$ 1,800,000	28%
Corporate Partner's Total Income Sourced to State A	\$ 5,556			

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

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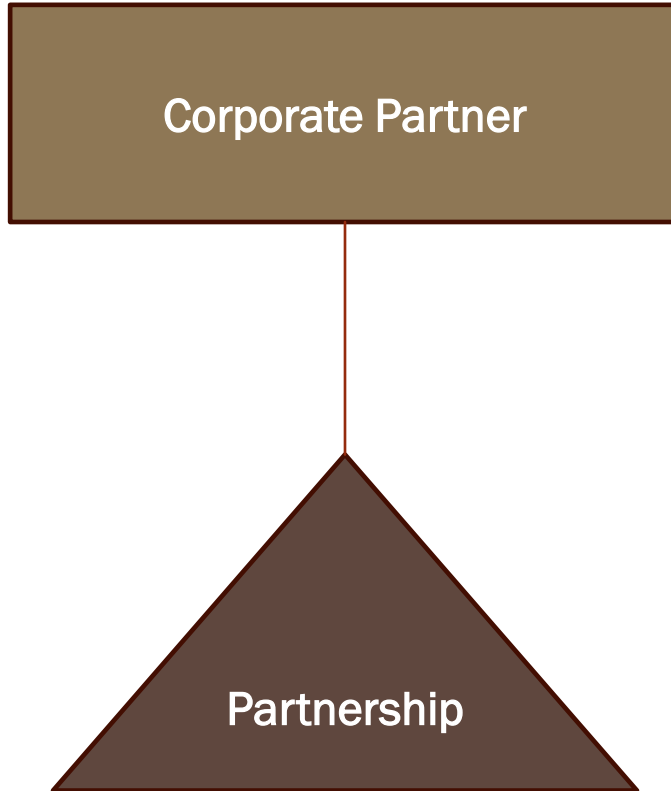
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COMPARISON:

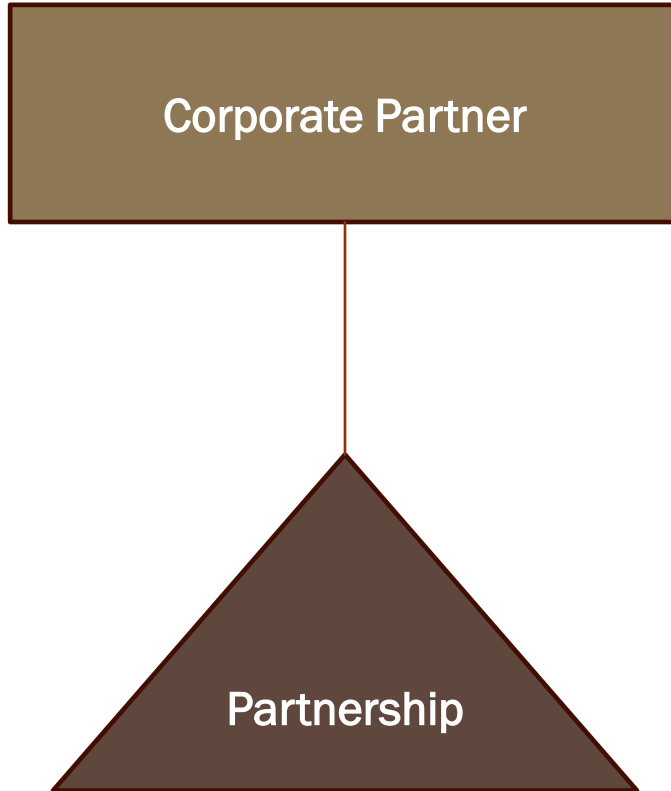
- No Blended - (\$30,000)
- Using Share of Capital - \$5,556
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 - \$2 million of sales everywhere

BLENDED APPORTIONMENT – SIMPLE EXAMPLE



- Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives only 20% of Partnership's items of income, expense, gain, and loss.

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$100,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere
- Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives **only 20% of Partnership's items of income, expense, gain, and loss.**

Sourcing Approach - **No Blending**

Partnership Income Sourced to State A (50% of \$100,000)	\$ 50,000
Corporate Partner's Share of State A Income (20% of \$50,000)	\$ 10,000
Corporate Partner's Own Income Sourced to State A (10% of \$100,000)	\$ 10,000
Total Corporate Partner Income Sourced to State A	<u>\$ 20,000</u>

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$100,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere
- Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives **only 20% of Partnership's items of income, expense, gain, and loss.**

Sourcing Approach – **Using Share of Partnership Capital** to Determine Share of Factors

Corporate Partner's Share of Total Partnership Income (20% of \$100,000)	\$ 20,000			
Corporate Partner's Own Income	\$ 100,000			
Total Apportionable Income of Corporate Partner	<u>\$ 120,000</u>	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (using 80% of capital)		\$ 400,000	\$ 800,000	
Corporate Partner's Own Factors		\$ 200,000	\$ 2,000,000	
Total Corporate Partner's Sales Factor		<u>\$ 600,000</u>	<u>\$ 2,800,000</u>	21%
Corporate Partner's Total Income Sourced to State A	<u>\$ 25,714</u>			

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$100,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere
- Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives **only 20% of Partnership's items of income, expense, gain, and loss.**

Sourcing Approach – **Using Share of Partnership Income** to Determine Share of Factors

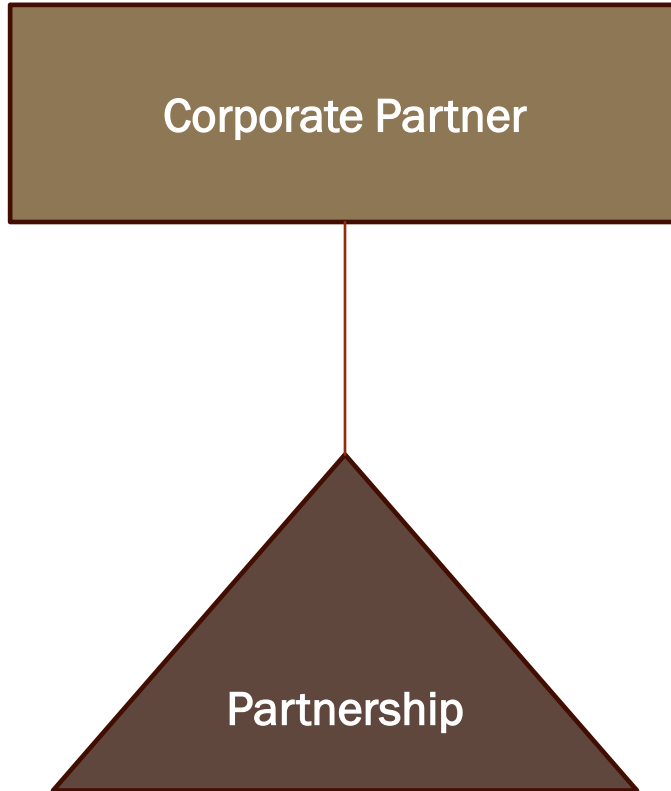
Corporate Partner's Share of Total Partnership Income (20% of \$100,000)	\$ 20,000			
Corporate Partner's Own Income	\$ 100,000			
Total Apportionable Income of Corporate Partner	<u>\$ 120,000</u>	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (using 20% of income)		\$ 100,000	\$ 200,000	
Corporate Partner's Own Factors		\$ 200,000	\$ 2,000,000	
Total Corporate Partner's Sales Factor		<u>\$ 300,000</u>	<u>\$ 2,200,000</u>	14%
Corporate Partner's Total Income Sourced to State A	<u>\$ 16,364</u>			



COMPARISON:

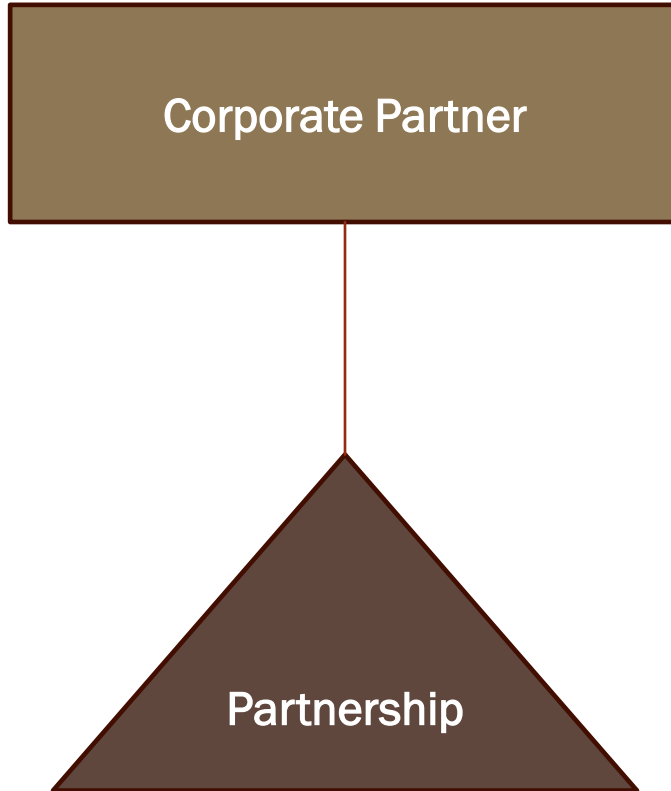
- No Blended - \$20,000
- Using Share of Capital - \$25,714
- Using Share of Income - \$16,364

BLENDING APPORTIONMENT – SIMPLE EXAMPLE



- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$50,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere

BLENDED APPORTIONMENT – SIMPLE EXAMPLE



- Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives **only a special allocation of a single item – a \$200,000 partnership capital loss.** (That is – even though the partnership has net income – it also has a \$200,000 capital loss offset by other income.)

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$50,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere
- Assume:
 - Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives only a special allocation of a single item – a \$200,000 partnership capital loss.

Sourcing Approach - No Blending

Share of Partnership Capital Loss Sourced to State A (50% of -\$200,000)	\$ (100,000)
Corporate Partner's Share of State A Income (100% of the loss)	\$ (100,000)
Corporate Partner's Own Income Sourced to State A (10% of \$50,000)	\$ 5,000
Total Corporate Partner Income Sourced to State A	\$ (95,000)

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$50,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere
- Assume:
 - Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives only a special allocation of a single item – a \$200,000 partnership capital loss.

Sourcing Approach – Using Share of Partnership Capital to Determine Share of Factors

Corporate Partner's Special Allocation of Partnership Capital Loss	\$ (200,000)			
Corporate Partner's Income	\$ 50,000			
Total Apportionable Income of Corporate Partner	\$ (150,000)	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (using 80% capital share)		\$ 400,000	\$ 800,000	
Corporate Partner's Own Factors		\$ 100,000	\$ 1,000,000	
Total Corporate Partner's Sales Factor		\$ 500,000	\$ 1,800,000	28%
Corporate Partner's Total Income Sourced to State A	\$ (41,667)			

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

- State A uses a single sales factor.
- Partnership has:
 - \$50,000 of apportionable net income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$50,000 of apportionable net income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere
- Assume:
 - Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives only a special allocation of a single item – a \$200,000 partnership capital loss.

Sourcing Approach – Using Share of Partnership Income to Determine Share of Factors

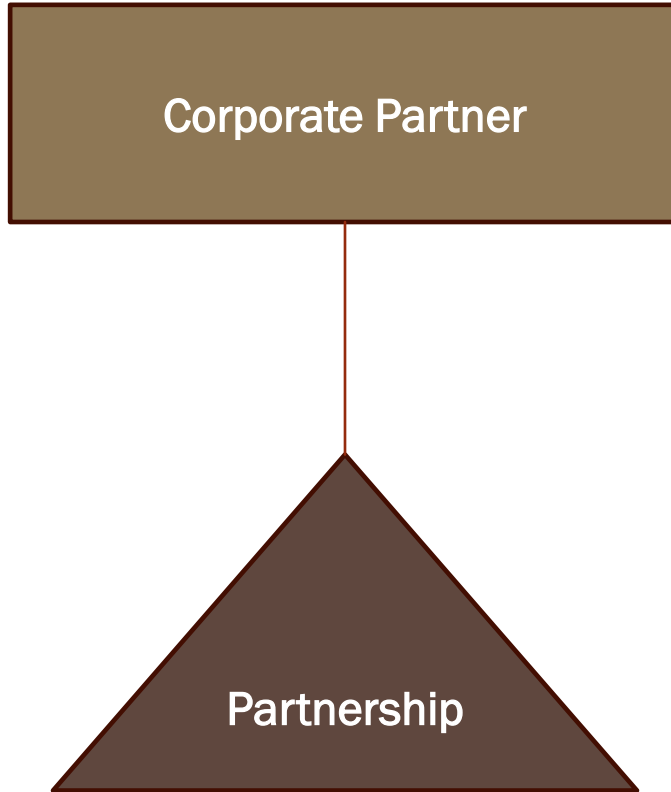
Corporate Partner's Special Allocation of Partnership Capital Loss	\$ (200,000)			
Corporate Partner's Income	\$ 50,000			
Total Corporate Apportionable Income of Corporate Partner	<u>\$ (150,000)</u>			
Corporate Partner's Share of Partnership Factors (using (\$200,000) ÷ \$100,000 = -200%)		State A	Everywhere	
Corporate Partner's Own Factors		\$ (1,000,000)	\$ (2,000,000)	
Total Corporate Partner's Sales Factor		\$ 100,000	\$ 1,000,000	
Corporate Partner's Total Income Sourced to State A	<u>\$ (135,000)</u>	<u>\$ (900,000)</u>	<u>\$ (1,000,000)</u>	90%



COMPARISON:

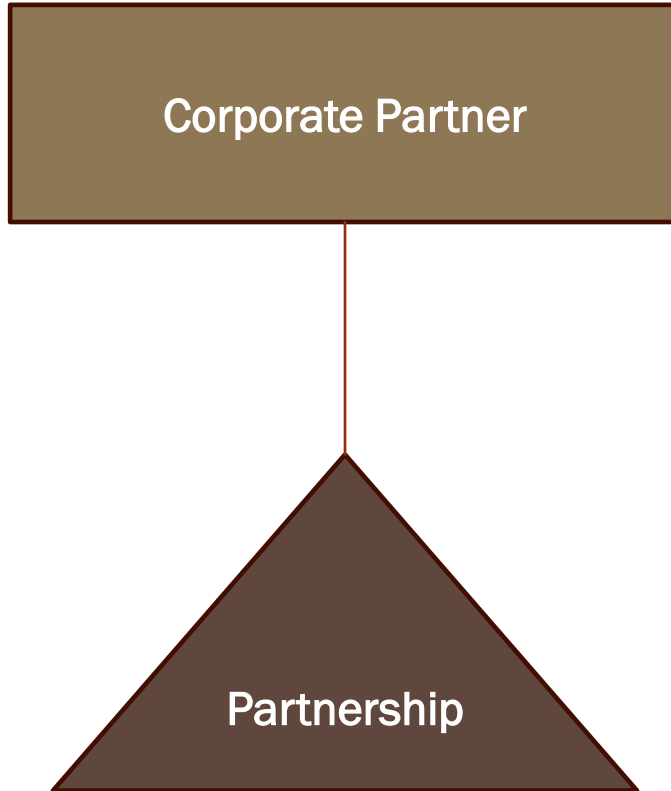
- No Blended - (\$95,000)
- Using Share of Capital - (\$41,667)
- Using Share of Income - (\$135,000)

BLENDING APPORTIONMENT – SIMPLE EXAMPLE



- State A uses a single sales factor.
- Partnership has:
 - \$100,000 of apportionable income
 - \$500,000 of sales in State A
 - \$ 1 million of sales everywhere
- Corporate Partner has:
 - \$100,000 of apportionable income
 - \$200,000 of sales in State A.
 - \$2 million of sales everywhere

BLENDED APPORTIONMENT – SIMPLE EXAMPLE



- Assume:
 - Corporate Partner has an 80% share of Partnership capital
 - Corporate Partner receives 80% of Partnership's items of income, expense, gain, and loss.
 - Corporate Partner receives a guaranteed payment of \$40,000 for services done for the partnership.

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

Sourcing Approach - No Blending

Share of Partnership Loss Sourced to State A (50% of \$100,000)	\$	50,000		
Share of Guaranteed Payment Sourced to State A (50% of \$40,000)			\$	20,000
Corporate Partner's Share - Items Sourced to State A	\$	40,000	\$	20,000
Total Corporate Partner Income Sourced to State A			\$	60,000

Sourcing Approach – Using Share of Partnership Capital to Determine Share of Factors

Corporate Partner's Share of Partnership Factors (using 80% capital share)	\$	80,000					
Guaranteed Payment	\$	40,000					
Corporate Partner's Own Income	\$	100,000					
Total Apportionable Income of Corporate Partner	\$	220,000	State A	Everywhere	Ratio		
Corporate Partner's Share of Partnership Factors (using 80% capital share)			\$	400,000	\$	800,000	
Corporate Partner's Own Factors			\$	100,000	\$	1,000,000	
Less Guaranteed Payment (Assuming All Sourced Outside State A)			\$	-	\$	(40,000)	
Total Corporate Partner's Sales Factor			\$	500,000	\$	1,760,000	28.41%
Corporate Partner's Total Income Sourced to State A	\$	62,500					

BLENDING APPORTIONMENT – SIMPLE EXAMPLE

Sourcing Approach - Share of Partnership Income

Corporate Partner's Share of Partnership Income	\$	80,000			
Corporate Partner's Guaranteed Payment	\$	40,000			
Corporate Partner's Own Income	\$	100,000			
Total Apportionable Income of Corporate Partner	\$	<u>220,000</u>	State A	Everywhere	Ratio
Corporate Partner's Share of Partnership Factors (using $(80\% \times \$100,000) + \$40,000$ / $(100,000 + 40,000) = 83\%$)	\$	428,550	\$	857,100	
Corporate Partner's Own Factors (Less Guaranteed Payment)	\$	<u>100,000</u>	\$	<u>960,000</u>	
Total Corporate Partner's Sales Factor	\$	<u>528,550</u>	\$	<u>1,817,100</u>	29.09%
Corporate Partner's Total Income Sourced to State A	\$	<u>63,993</u>			

Comparison:

- No Blended - \$60,000
- Using Share of Capital - \$62,500
- Using Share of Income - \$63,993

PLAN FOR THE NEXT CALL

- Continue working on examples and calculating results while adding complexity to determine how the different approaches may work in practice.
- Consider the information needed for each approach.
- Begin to consider the type of anti-abuse rules that may be necessary.



QUESTIONS???

AND FEEL FREE TO REACH OUT





UPCOMING MEETINGS AND CALLS

THE UNIFORMITY COMMITTEE'S IN-PERSON MEETING IS TUESDAY, NOVEMBER 19, 2024 IN SANTA FE, NM

THE NEXT WORK GROUP MEETING WILL BE WEDNESDAY, OCTOBER 16, 2024

PARTNERSHIP TRAINING – WEEK OF JANUARY 13, 2025 IN NEW ORLEANS