State Taxation of Partnerships
Status Report

FEBRUARY 19, 2025

NOTE:

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

UPDATE ON PROJECT ISSUE OUTLINE

MULTISTATE TAX COMMISSION

An intergovernmental state tax agency whose mission is to promote uniform and consistent tax policy and administration among the states, assist taxpayers in achieving compliance with existing tax laws, and advocate for state and local sovereignty in the development of tax policy.

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State Taxation of Partnerships

Project Description

At its meeting in April 2021, the Uniformity Committee took up a project on state taxation of partnerships based on the recommendations of the Standing Subcommittee that a work group be established to consider issues affecting:

- Sourcing of partnership operating income and partnership items for state tax purposes;
- Sourcing and taxation of gains and losses from the sale of partnership interests;
- Entity level taxation issues including transfer pricing or combined filing issues; and
- Other administrative and enforcement issues including information reporting and withholding.

On this project page and the links below, you will find:

- Information about upcoming and past meetings
- Project materials including whitepaper outline drafts
- Written comments and feedback
- Additional background information

Upcoming Meeting Notice

The project issue outline has been updated. See that Issue Outline as of 1/1/2025 here: (PDF) (Word)

Agenda and Materials

Meetings are held each month on the third Wednesday at 3:00 p.m. Eastern

The regularly scheduled meeting of January 15, 2025 is cancelled. The next meeting will be February 19, 2025.

AGENDA

I. Welcome and Introductions

II. Initial Public Comment

III. Status Report on State Tax Sourcing Issues in Complex Partnership Structures

IV. New Business

Dial-in/Log-in Information

Log-In or Use App to Join ZoomGov Meeting

https://www.zoomgov.com/j/1614807575?pwd=aVFrOG5CbFBsTmR0bDdoZFZSY0J1Zz09

Meeting ID: 161 480 7575 – Passcode: 503412

Dial by your location

+1 669 254 5252 US (San Jose)
+1 669 216 1590 US (San Jose)
+1 646 828 7666 US (New York)
+1 551 285 1373 US (New Jersey)

MULTISTATE TAX COMMISSION

STATE TAXATION OF PARTNERSHIPS
ISSUE OUTLINE

Current as of January 1, 2025.
With reformatting and substantive changes to the January 15, 2023 version, particularly in Section 2.1 on Jurisdiction and Nexus issues.
Other substantive changes are highlighted.

Important:

- **This Outline does not constitute tax advice.**
- **Its purpose is to identify issues in state taxation of partnerships that the MTC work group assigned to this project may want to address.**
- **It is a working draft and may change over time.**
- **As the work group studies particular issues, any additional research, findings, or recommendations may be contained in other project documents including white papers or draft models available on the project page on the MTC website – HERE.**

PARTNERSHIP TRAINING FOR STATES

HELD ON JANUARY 13-15

Total of 84 attendees from 24 states

Continuing to develop additional training – including for the MTC Learning Management System

UPDATE ON WHITE PAPER

SCOPE & ISSUES

- Sourcing partnership income where:
  - Partner is a corporation
  - Partnership structure has –
    - Tiers
    - Intercompany transactions
    - Special allocations

DRAWING ON MULTI-STATE RESEARCH

- See the current research - HERE
- States generally source partnership income using the same rules as for corporate and proprietorship businesses, including formulary apportionment.
- A number use "blended" apportionment in some cases—combining the partner's share of partnership factors with the partner's own factors.
- Blended apportionment raises issues not fully addressed—especially where there are special allocations and intercompany transactions.

OUTLINE

I. **Scope**

The white paper would address sourcing where the partner is a corporation, the partnership is a tiered structure, or situations where there are intercompany transactions or special allocations. It would exclude investment partnerships but include guaranteed payments (sourced in the same way as distributive share).

II. **Essential Terms**

(Drafted.)

III. **Importance of the Attribution Principle**

(Drafted.)

OUTLINE (CONT'D)

IV. **Sourcing Non-Apportionable Partnership Income - Generally**

A. Determination of non-apportionable income (see slides below)

B. Sourcing non-apportionable income (see slides below)

V. **Sourcing Apportionable Partnership Income**

A. Corporate and tiered partners – need for blended apportionment

B. How blended apportionment may be applied

1) Share of partnership factors

2) Effects of special allocations

3) Effects of intercompany transactions

C. When blended apportionment may be applied and legal and other limitations

OUTLINE (CONT'D)

VI. Anti-Abuse Rules

A. Special allocations and substantial economic effect
B. Other – including equitable apportionment rules

VII. Administrative Issues

A. How information is reported by partnerships and partners
B. How withholding may be affected
C. How composite returns or PTE taxes may be affected

VIII. Summary of State Research

(Drafted)

A. Treatment of corporate and tiered partnerships
B. Treatment of special allocations
C. Anti-abuse rules

SOURCING NON-APPORTIONABLE INCOME - GENERALLY

NOTE

- First - non-apportionable income must be distinguished from apportionable income derived from separate lines of business where separate apportionment formulas might be used.

- States generally apply the same rules applicable to corporations and businesses generally.

TREATMENT OF NON-APPORTIONABLE INCOME/ITEMS

General Rule # 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.

TREATMENT OF NON-APPORTIONABLE INCOME/ITEMS

General Rule #2 – Partner-Level Non-Apportionable Income –

- If 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.

3 POSSIBLE OUTCOMES

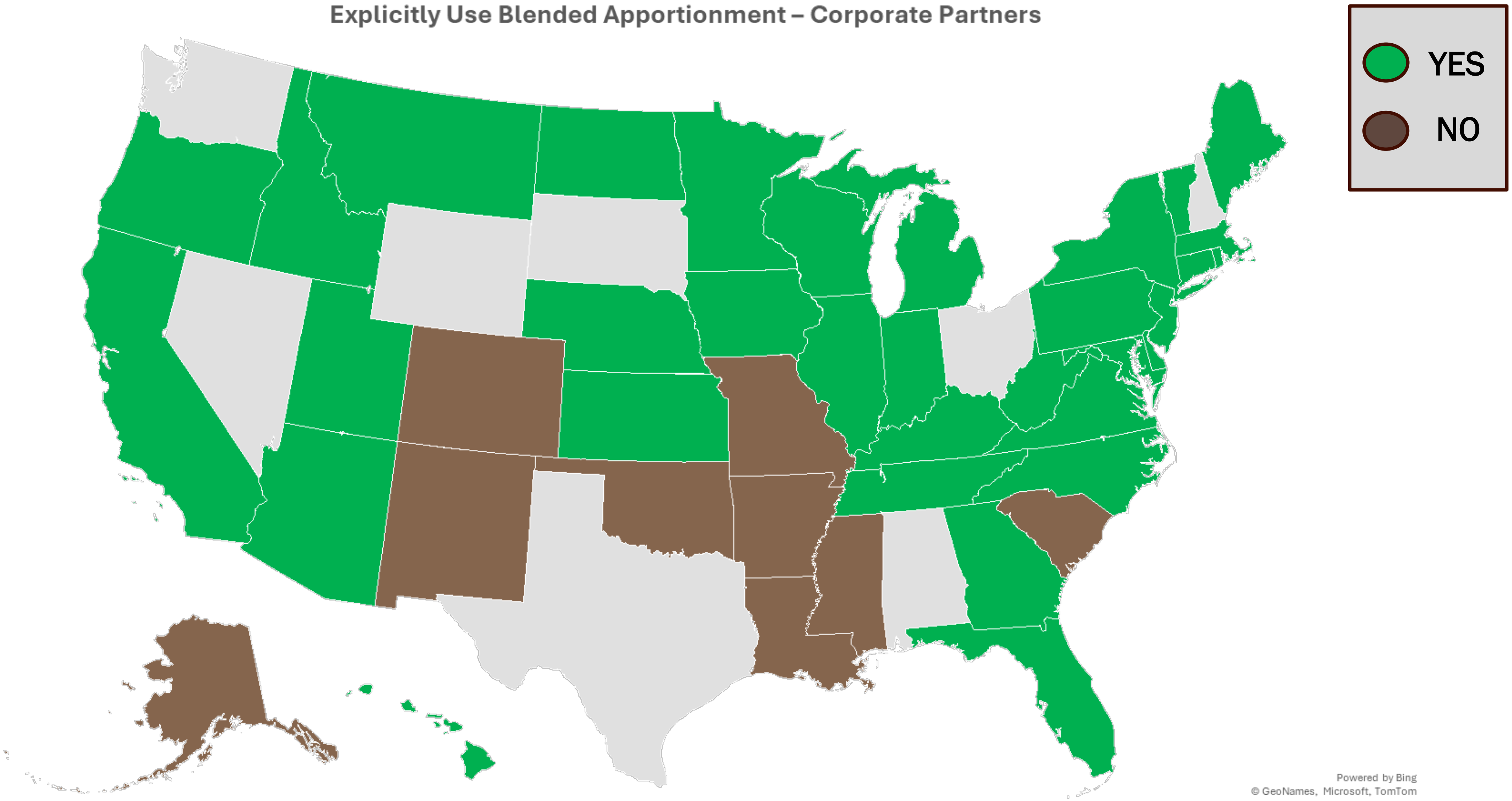
Income or Items Are:		Source:
Non-Apportionable to the Partnership NOTE: - Income is also non-apportionable to the Partner.	√	Apply general rules of assignment based on partnership-level information. Source is then attributed to the partner.
~~Non-Apportionable to the Partnership~~ Apportionable to the Partnership Non-Apportionable to the Partner	 √ √	Apply formulary apportionment based on partnership-level information. Source is then attributed to the partner.
~~Non-Apportionable to the Partnership~~ Apportionable to the Partnership ~~Non-Apportionable to the Partner~~ Apportionable to the Partner	 √ √	States may use blended apportionment, especially for corporate partners.

SOURCING APPORTIONABLE INCOME

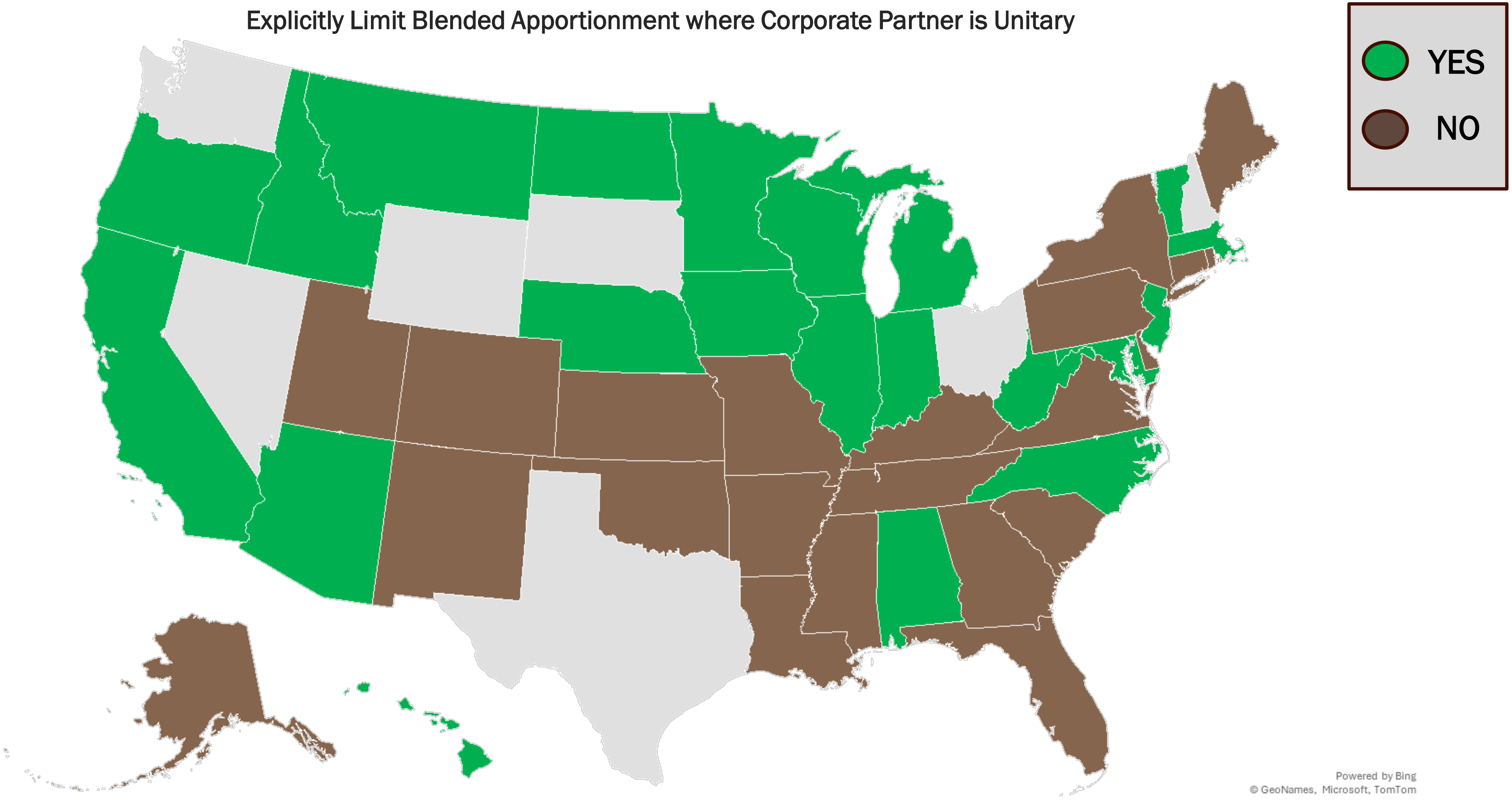
GENERALLY

- States use formulary apportionment.
- Default Rule – Use the factors of the entity recognizing the income.
- Blended Apportionment – Some states, along with the MTC combined corporate filing model, require a combination of the taxpaying partner factors with its share of the partnership factors for corporate partners.

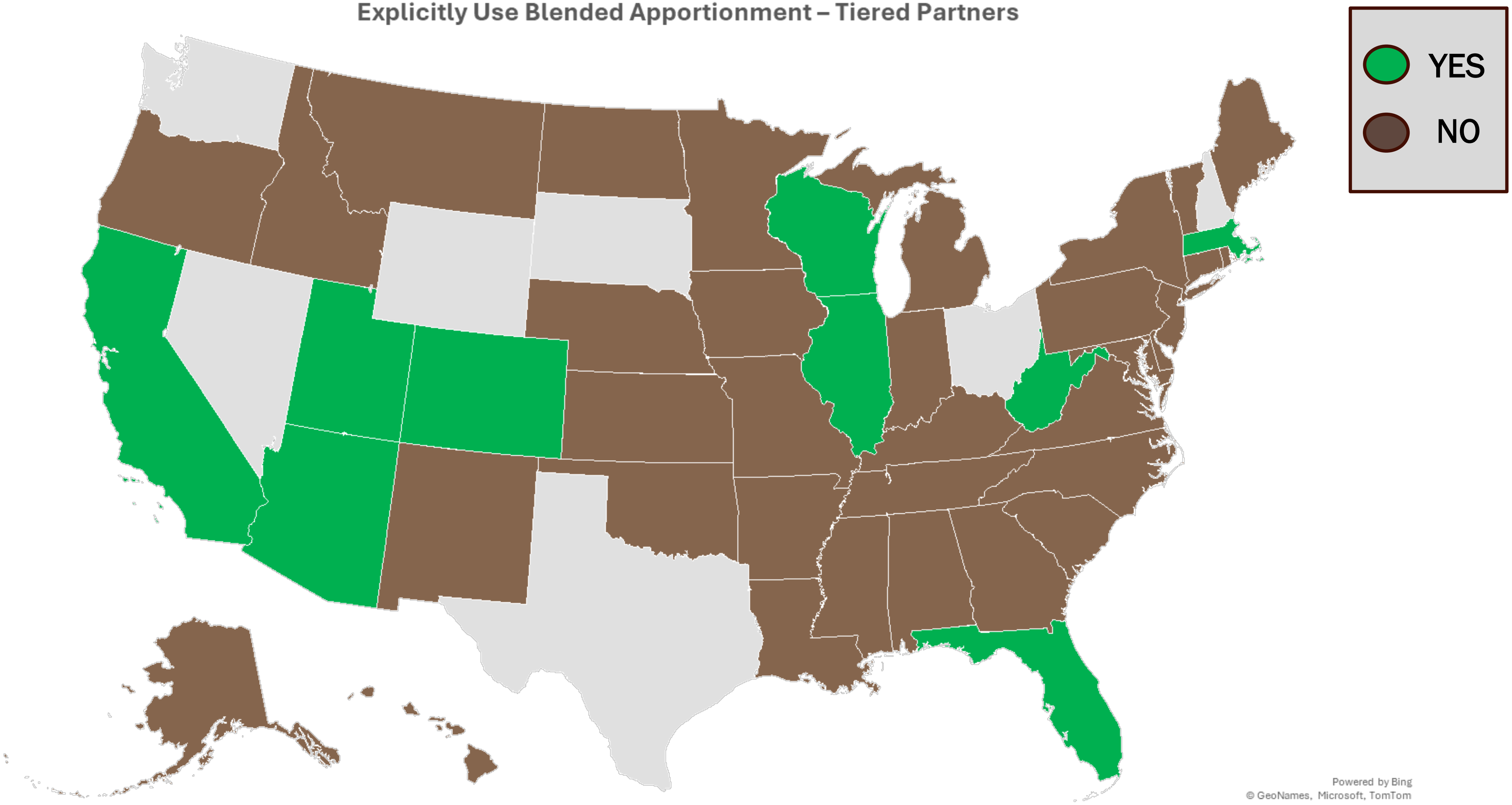
Explicitly Use Blended Apportionment – Corporate Partners



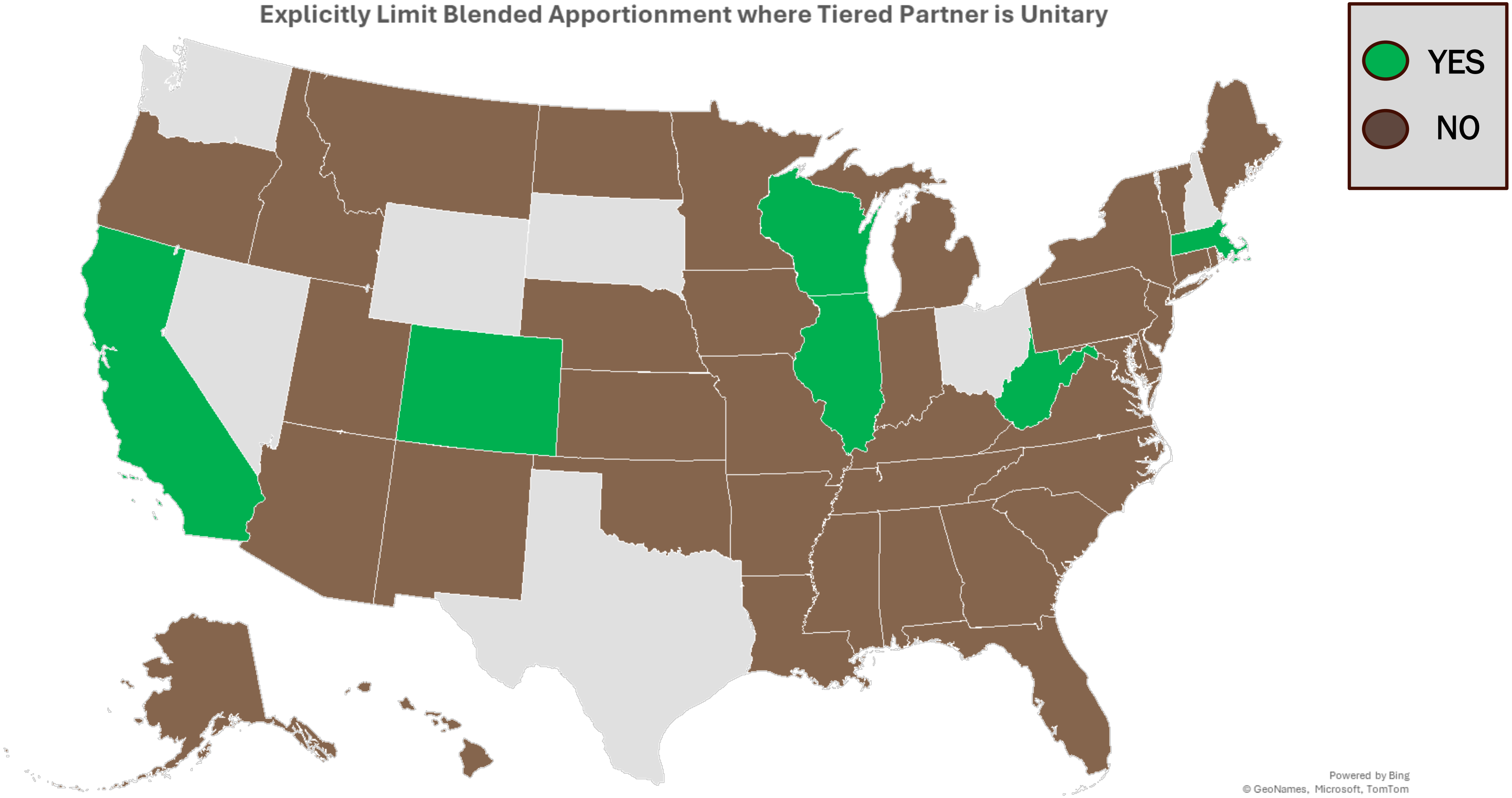
Explicitly Limit Blended Apportionment where Corporate Partner is Unitary

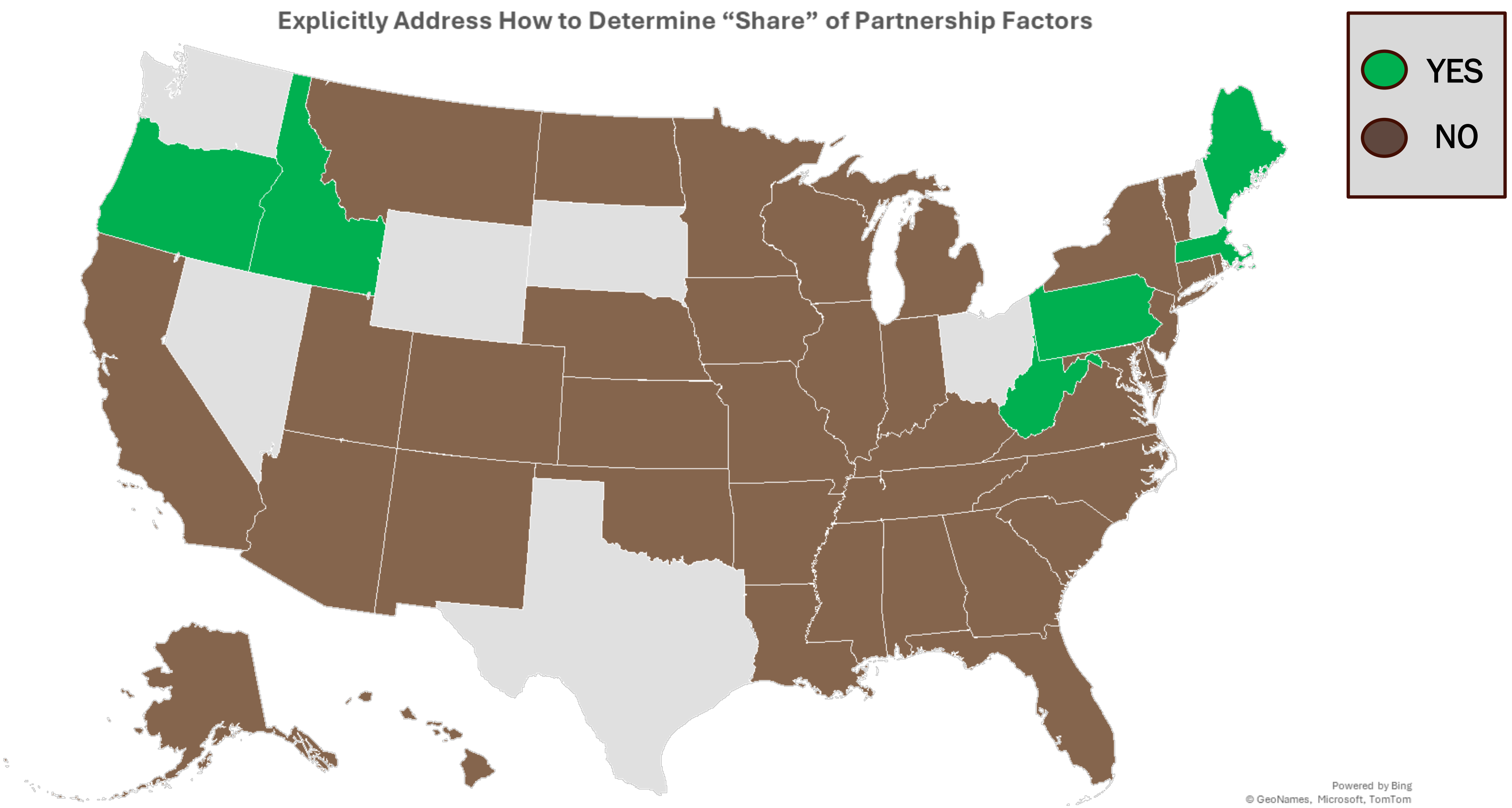


Explicitly Use Blended Apportionment – Tiered Partners



Explicitly Limit Blended Apportionment where Tiered Partner is Unitary




Explicitly Address How to Determine "Share" of Partnership Factors
YES
NO
Powered by Bing
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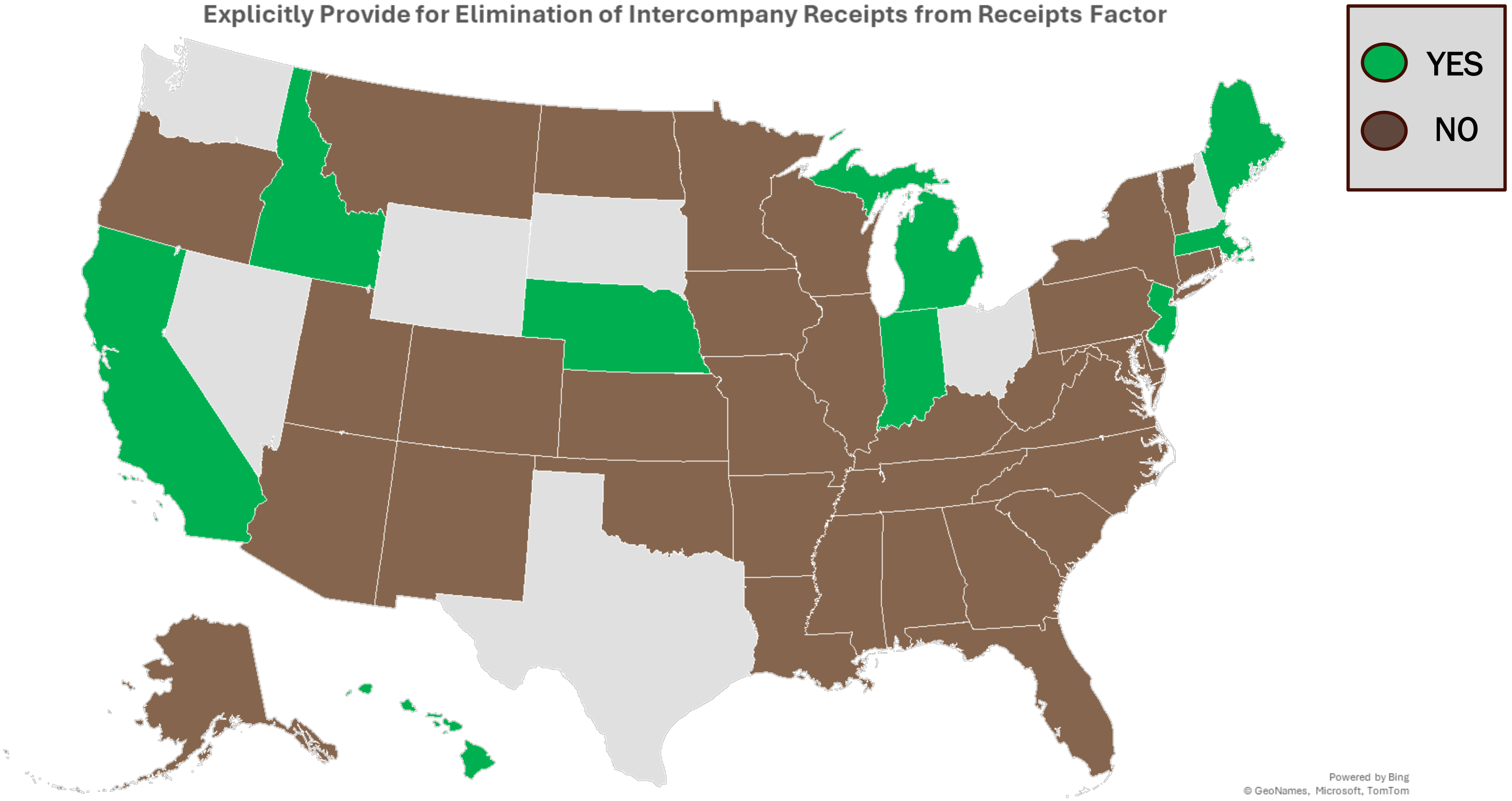
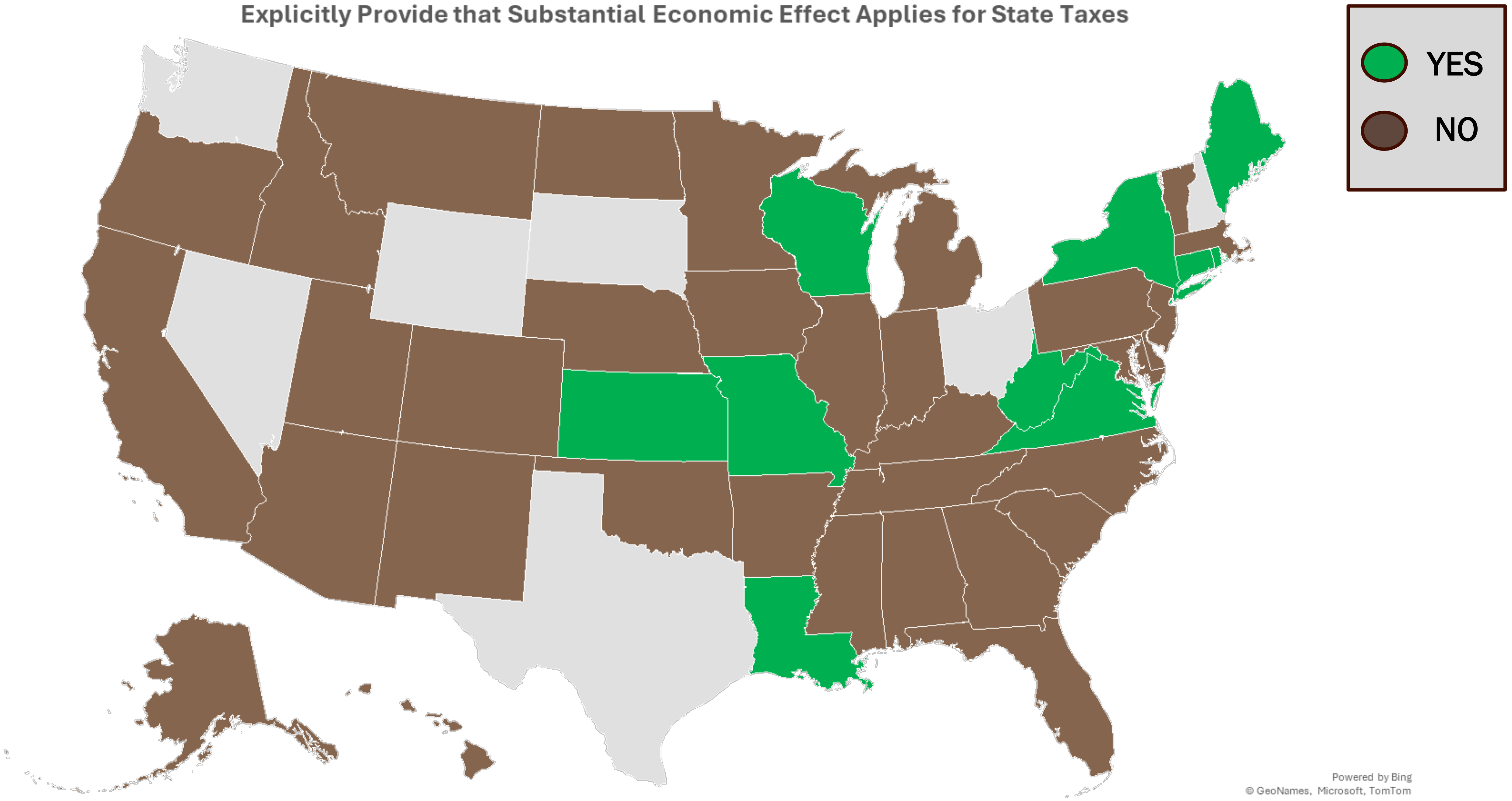
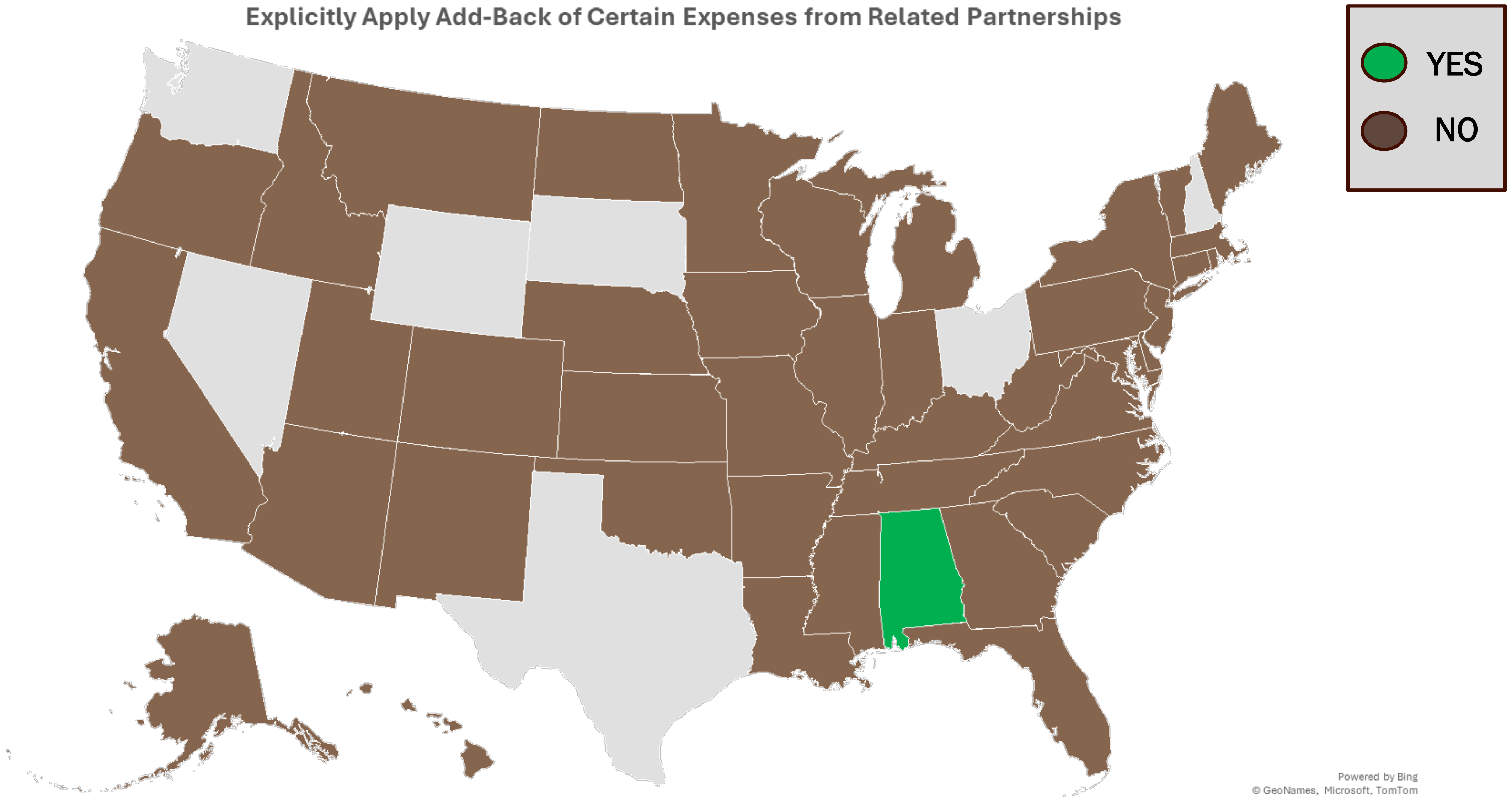
Explicitly Provide for Elimination of Intercompany Receipts from Receipts Factor



Explicitly Provide that Substantial Economic Effect Applies for State Taxes



Explicitly Apply Add-Back of Certain Expenses from Related Partnerships



BIG “HOW” QUESTION:

How do partners determine share of partnership factors to include?

- Directly attribute the receipts to particular partners based on the partnership items making up their distributive share.
- Use a ratio of the partner’s “interest in the partnership” (same as federal rules under 704(b))
- Use a ratio of the partner’s share of capital
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How do we solve calculation problems?

PROBLEM NO. 2 WITH SPECIAL ALLOCATIONS

- Should the fact that a partner receives certain special allocations of partnership income affect which amounts go into the apportionment factor?
- Example—
  - Assume Partnership is engaged in two related activities – renovating commercial real property and performing engineering services.
  - Corporate Partner provides support for renovation activities and is allocated 80% of the income (and expense) from those activities, but only 20% of the income (and expense) from engineering services.
  - Should this affect the share of receipts from renovation activities versus engineering services that the corporate partner includes in the blended receipts factor?

SIMPLE EXCEL WORKBOOK WITH DIFFERENT SOURCING APPROACHES

- Comparing results of assignment, separate apportionment, and blended apportionment with certain variations—to determine if blended apportionment is workable.
- Example in the workbook:
  - Uses a single corporate partner
  - Focuses on the receipts factor
  - Use of an absolute value distributive share ratio for the blended apportionment approach
  - Also illustrates how elimination if partnership-partner charges affects the result.

INFORMAL STUDY GROUP TO REVIEW THE MODEL

- Volunteers would:
  - Review the Excel workbook.
  - Try inputting different data to see how results of the different approaches vary.
  - Consider tweaks or changes that may be needed to make an approach work.
  - Provide input to staff for consideration so that the results can be included and used in the drafting of the white paper.
  - Report out the results to the work group.

QUESTIONS???

AND FEEL FREE TO REACH OUT

UPCOMING MEETINGS AND CALLS

NEXT CALLS –

MARCH 19, 2025

APRIL 16, 2025

MTC MEETINGS – SPOKANE, WA – APRIL 28 – MAY 1, 2025 (UNIFORMITY COMMITTEE – APRIL 29)