



June 16, 2025

Ms. Laurie McElhatton
Chair, MTC Work Group on State
Taxation of Partnerships
c/o California Franchise Tax Board
Rancho Cordova, CA 95741-1720

Ms. Helen Hecht
Uniformity Counsel
Multistate Tax Commission
444 North Capitol Street, Suite 425
Washington, DC 20001

Mr. William C. Barber
Counsel
Multistate Tax Commission
444 North Capitol Street, Suite 425
Washington, DC 20001

Re: MTC Draft White Paper on State Tax Sourcing of Partnership Income & the Blended Apportionment Method (draft dated May 19, 2025)

Dear Ms. McElhatton, Ms. Hecht, and Mr. Barber:

The American Institute of CPAs (AICPA) appreciates the opportunity to provide comments on the Multistate Tax Commission (MTC) [draft white paper on State Tax Sourcing of Partnership Income and the Blended Apportionment Method](#) (“white paper”) (draft dated May 19, 2025) that is part of the MTC’s landmark Project on the State Taxation of Partnerships (“work group”).

Our attached comments include the following recommendations:

General Comments:

Overall, we agree with the need to offer the states clear guidance on uniformity. Uniformity helps taxpayers with easier compliance and state tax authorities with easier administration.

However, we have the below recommendations with the general approach of the draft white paper.

1. Define the impacted taxpayers and clarify if the MTC will focus on the ultimate taxpaying partner recognizing income from a partnership interest or the partnership/upper-tier partnership partners
2. Provide guidance on determining a partner’s share of the partnership’s state modifications

Specific Comments:

We provide below specific comments and reference the white paper pages for each item. We especially note items 16 and 17 regarding the white paper position that unity is not required for blended apportionment.

1. Provide a more specific definition of “complex” partnership structures (on page 5)
2. Add language regarding states not applying the same approach to sourcing multistate income of a business regardless of form of business (on page 7)
3. Clarify which rules of assignment should be referred to for defining nonbusiness items (on page 7)
4. Clarify example 1, for residents that “100% of their income is subject to tax in their resident state” as opposed to “source 100% of their income to the state” (on page 8)
5. Clarify example 1 language regarding “P1 has \$100,000 of net income apportioned entirely to State A” (on page 8)
6. Clarify in example 3 why the sourcing rules are applied at the partner level rather than the partnership level (on page 9)
7. Clarify the use of federal partnership tax rules and terms (on pages 13-16)
8. Refer to the DC Circuit Court’s recent *Rawat* decision (on page 19 and page 36)
9. Provide guidance regarding built-in gains (losses) to clarify why there is a different tax treatment with partnerships versus corporations (on page 21)
10. Simplify the proposed apportionment factors/sourcing rules applicable to the year of the contribution/distribution for built-in gains (losses) (on pages 21-22 and pages 53-54)
11. Provide guidance regarding transactions involving partners or shareholders who act outside their capacity as partners or shareholders to clarify why there is a different treatment of partnerships versus corporations (on page 23)
12. Add language noting that some states already have anti-abuse rules that provide for ignoring a partnership agreement if its application results in sourcing income to a state for the sole purpose of evading state tax (on page 27)
13. Add a step or consideration to the framework to first determine if the taxpayer is carrying on a trade or business before determining whether it is unitary (on pages 28-31)
14. Add language noting that the state sourcing rule should not automatically assume the partnership is engaged in a business activity that gives rise to apportionable income (on page 39)

15. Apply the item-based approach instead of the distributive share-based approach for determining the share of a partner's apportionment factors (on page 48)
16. Revise the statement that fair apportionment is not entirely dependent on the unitary business principle (on page 51)
17. Remove the phrase "while not clearly required for blended apportionment" from the statement on the unitary business principle (on page 51)

* * * * *

The AICPA is the world's largest member association representing the accounting profession, with more than 397,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Brian Myers, Chair of the AICPA SALT TRP at (317) 208-2478 or Brian.Myers@crowe.com ; Ning Yim, AICPA Senior Manager, Tax Policy & Advocacy at (202) 434-9201 or Ning.Yim@aicpa-cima.com; or me at (610) 217-4495 or CheriFreeh@gmail.com.

Sincerely,



Cheri Freeh, CPA, CGMA
Chair, AICPA Tax Executive Committee

**AICPA Comments on the
MTC Draft White Paper on State Tax Sourcing of Partnership Income & the Blended
Apportionment Method (draft dated May 19, 2025)
June 16, 2025**

The American Institute of CPAs (AICPA) is pleased to provide, at the MTC's request, the below comments on the Multistate Tax Commission (MTC) [draft white paper on State Tax Sourcing of Partnership Income and the Blended Apportionment Method](#) ("white paper") (draft dated May 19, 2025) that is part of the MTC's landmark Project on the State Taxation of Partnerships ("work group").

Background

At its meeting in April 2021, the MTC Uniformity Committee initiated a project on the state taxation of partnerships based on the recommendations of the MTC 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.

As a result, the MTC Uniformity Committee's State Taxation of Partnerships Project started in 2021, and included various partnership project working groups, including a state tax sourcing working group that recently developed a draft white paper on state tax sourcing of partnership income and the blended apportionment method and asked for input and feedback on it. The MTC Partnership Project also developed a partnership sourcing exercise Excel workbook (draft dated March 25, 2025). The AICPA is providing feedback through the comments below.

General Comments

Overall, we agree with the need to offer the states clear guidance on uniformity. Uniformity helps taxpayers with easier compliance and state tax authorities with easier administration.

However, we have the below recommendations with respect to the general approach of the draft white paper.

1. Define the impacted taxpayers and clarify if the draft white paper will focus on the ultimate taxpayer partner recognizing income from a partnership interest or the partnership/upper-tier partnership partners

The AICPA recommends defining the taxpayers to whom these rules are applicable, e.g., corporate taxpayers with a direct or indirect interest in a partnership. Otherwise, it is unclear to whom the MTC's recommendations would apply in a tiered structure that has a mix of partnerships, corporations, individuals, etc.

The AICPA also recommends acknowledging that state tax forms will need to be revised and updated to implement the rules in a straight-forward manner.

The issues, examples, and proposed recommendations in the white paper seem to focus on the ultimate taxpaying partner recognizing income from a partnership interest, and not

necessarily a direct or indirect upper-tier partnership partner. For example, the white paper does not address state sourcing rules applicable for pass-through entity taxes (PTET), nonresident withholding, or composite tax computed by a partnership.

The AICPA also recommends clarifying if the draft white paper will focus on the ultimate taxpayer partner recognizing income from a partnership interest or the partnership/upper-tier partnership partners.

2. Provide guidance on determining a partner’s share of the partnership’s state modifications

The AICPA recommends providing clear guidance specifically on how to determine a partner's share of the partnership's state modifications. Accurately determining each partner's share of the partnership's state modifications is essential to ensure proper allocation of income, deductions, and credits in accordance with state tax laws. Such guidance supports the accurate calculation of each partner's state taxable income, helping to ensure compliance and reducing the risk of reporting errors.

Specific Comments

We provide below specific comments and reference the white paper pages for each item. We especially note items 16 and 17 regarding the white paper position that unity is not required for blended apportionment.

1. Provide a more specific definition of “complex” partnership structures (on page 5)

On page 5 under the introduction to the white paper, the AICPA recommends revising the language to provide a more specific definition of “complex” in the statement listed as one of the reasons to support uniformity, “Today, there are many more large, **complex** (emphasis added) partnership structures than in prior years.”¹ We note that there is a lack of definition for complex partnership structures.

The footnote for that quote in the white paper refers to the Government Accountability Office (GAO), which defines large partnerships as having over \$100 million in assets and 100 or more partners. We note that many national professional services firms, including CPA firms and law firms, meet the GAO definition of a large partnership.

A more specific definition of “complex” will add clarity on why today’s partnership structures require state guidance on uniformity.

¹ Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships, U.S. Gov. Accountability Office, GAO-23-106020, Jul 27, 2023, <https://www.gao.gov/products/gao-23-106020>.

2. Add language regarding states not applying the same approach to sourcing multistate income of a business regardless of form of business (on page 7)

On page 7, the AICPA recommends adding language that some states do not apply the same approach to sourcing the multistate income of a business, regardless of the form of the business, under Section I. Important Context for Understanding the Issues, I.A. Example of Issues and Common Questions. For example, some states look to the individual income tax rules for sourcing income at the partnership level as opposed to the corporate sourcing rules.

3. Clarify which rules of assignment should be referred to for defining nonbusiness items (on page 7)

On page 7 under State Rules for Sourcing Multistate Income - Generally, the AICPA recommends clarifying which rules of assignment should be referred to (i.e., the rules of assignment that apply to the specific entity or the partners) for defining nonbusiness items.

4. Clarify example 1, for residents that “100% of their income is subject to tax in their resident state” as opposed to “source 100% of their income to the state” (on page 8)

On page 8 under example 1, Examples of Issues Created by the Pass-Through System, the AICPA recommends clarifying for residents that "100% of their income is subject to tax in their resident state" versus residents "source 100% of their income to the state."

5. Clarify example 1 language regarding “P1 has \$100,000 of net income apportioned entirely to State A” (on page 8)

On page 8 under example 1, Examples of Issues Created by the Pass-Through System, the AICPA recommends revising the language, “P1 has \$100,000 of net income apportioned entirely to State A.”

We note that the sentence may be inaccurate if the partnership is operating wholly within one state. The partnership may not have a right to apportion in that context.

6. Clarify in example 3 why the sourcing rules are applied at the partner level rather than the partnership level (on page 9)

On page 9 under example 3, Examples of Issues Created by the Pass-Through System, the AICPA recommends clarifying why the sourcing rules are applied at the partner level rather than the partnership level.

We note that the second possible result states that X's share of the nonbusiness gain from the LLC is recognized as business (apportionable) income by X and subject to a blended apportionment formula. This would suggest that the character of the gain would change throughout the tiers, and that regardless of X's relationship to the LLC or the income-generating activity, the gain would be treated as apportionable business income.

This treatment seems contradictory to the subsequent discussion starting on page 27 of the importance of the attribution or conduit principle, which states that the partnership's business determines the character of its taxable activities, and the character of those items is then attributed or passes through to the partners. It would be helpful to clarify the appropriate and consistent treatment.

7. Clarify the use of federal partnership tax rules and terms (on pages 13-16)

On pages 13-16, the AICPA recommends clarifying the use of the federal partnership tax rules and terms where the white paper lists important terms and how they will be used in the white paper.

The use of federal tax rules and terms to control the meaning of common state tax terms can cause confusion. For example, the decision to use the term “assign” instead of “allocate,” in addition to “specifically assign and rules of assignment” creates confusion because the white paper is using “assign” both in the context of assigning receipts to the numerator for apportionment purposes and for allocating nonbusiness income to a particular state. In practice, most states use the term “allocate” for sourcing nonbusiness income to a particular state. In addition, we suggest that “non-apportionable income” could more simply be defined as “all income other than apportionable income.”

8. Refer to the DC Circuit Court’s recent *Rawat* decision (on page 19 and page 36)

On page 19 and page 36, the AICPA recommends a brief discussion of the DC Circuit Court’s recent *Rawat*² decision in the white paper. In several places, the white paper refers to federal sourcing rules under section³ 875 and Treas. Reg. § 1.702-1(a)(8)(ii).

The recent DC Circuit Court decision in *Rawat* (July 2024) includes a useful discussion of these concepts that is highly relevant conceptually to this project as it relates to the sale of a partnership interest and gain recognized under section 751.

9. Provide guidance regarding built-in gains (losses) to clarify why there is a different tax treatment with partnerships versus corporations (on page 21)

On page 21, the AICPA recommends providing guidance regarding built-in gains (losses) to clarify why there is a different tax treatment with partnerships versus corporations. The treatment of built-in gains (losses) for partnerships can affect the income ultimately sourced to particular states.

The deferred recognition of built-in gains (losses) on contributed property and distributed property are common to both partnerships and corporations.

Contributions to a partnership or a corporation are generally non-recognition events that do not result in taxable income or loss to the transferor at the time of contribution. Thus, a partner or shareholder generally can contribute property with a built-in gain or loss, the difference between the property’s tax basis and its fair market value at the time of contribution, without recognizing and being taxed on that gain or loss until the partnership or corporation transfers the property.

Providing guidance will add clarity on how the tax treatment of partnership built-in gains (losses) can affect the income ultimately sourced to particular states.

² *Rawat v. Commissioner of Internal Revenue*, No. 23-1142 (D.C. Cir. July 23, 2024).

³ All references to “section” (unless referencing the House reconciliation legislation) are to the Internal Revenue Code of 1986, as amended, and all references to “Reg. §”, “Prop. Reg. §”, and “regulations” are to U.S. Treasury regulations promulgated thereunder, unless otherwise specified.

10. Simplify the proposed apportionment factors/sourcing rules applicable to the year of the contribution/distribution for built-in gains (losses) (on pages 21-22 and pages 53-54)

On pages 21-22, and 53-54, the AICPA recommends simplifying the proposal regarding the recognition and sourcing rules of built-in gains (losses). The white paper proposes using the apportionment factors/sourcing rules applicable to the year of the contribution/distribution, which we think creates an additional administrative burden on both the partner and partnership in addition to diverging from the deferral treatment under the federal rules. Additionally, we point out that in a complex tiered partnership structure, the information necessary to apply sourcing rules applicable to a previous tax year (which could be long ago) may not be readily available.

11. Provide guidance regarding transactions involving partners or shareholders who act outside their capacity as partners or shareholders to clarify why there is a different treatment of partnerships versus corporations (on page 23)

On page 23, the AICPA recommends providing guidance regarding transactions involving partners or shareholders who act outside their capacity as partners or shareholders to clarify why there is a different treatment of partnerships versus the treatment of corporations.

On page 23, the white paper mentions that partners may engage in transactions with partnerships as unrelated parties. It is common for partnerships and corporations to engage in transactions where partners or shareholders receive payments from the partnership or corporation while not acting in their capacity as a partner or shareholder. For example, a partner might own a business that sells goods or services, and the business may provide those goods or services to the partnership in exchange for payment in the same way as to an unrelated person. In this case, the transaction would be treated as a transaction between unrelated parties.

Providing guidance will add clarity on how the treatment of partnerships regarding transactions involving partners who act outside their capacity as partners can affect the income ultimately sourced to particular states.

12. Add language noting that some states already have anti-abuse rules that provide for ignoring a partnership agreement if its application results in sourcing income to a state for the sole purpose of evading state tax (on page 27)

On page 27 under State Conformity and Federal Anti-Abuse Provisions – Implications, bullet point 4 - States may also need additional anti-abuse rules to prevent the use of partnerships to shift income, the AICPA recommends adding language noting that some states already have anti-abuse rules that provide for ignoring a partnership agreement if its application results in sourcing income to a state for the sole purpose of evading state tax (e.g., NY).

13. Add a step or consideration to the framework to first determine if the taxpayer is carrying on a trade or business before determining whether it is unitary (on pages 28-31)

On pages 28-31 under I.F. General State Sourcing Rules for Income of Businesses, the AICPA recommends adding a step or consideration to the framework to first determine if the taxpayer is carrying on a trade or business before determining whether it is unitary.

If the taxpayer is not engaged in a trade or business to begin with, then the taxpayer should not apply the tests for business income. That is consistent with the conduit rule - if the partnership is just holding stock or another partnership interest as an investment and not in connection with a business that generates apportionable income, then the character of the income/gain at the partnership level is just as if the partner realized it directly.

14. Add language noting that the state sourcing rule should not automatically assume the partnership is engaged in a business activity that gives rise to apportionable income (on page 39)

On page 39 under I.G. Summary – Issues & Important Context – Lessons, the AICPA recommends adding language noting that the state sourcing rule should not automatically assume that the partnership is engaged in a business activity that (in some years) gives rise to apportionable income; instead, it should be apparent from the state’s written rules that there is a threshold question — whether the partnership is engaged in a unitary business in the first place.

15. Apply the item-based approach instead of the distributive share-based approach for determining the share of a partner’s apportionment factors (on page 48)

On page 48, the AICPA recommends using an item-based approach instead of the distributive share-based approach for determining the share of a partner’s apportionment factors. An item-based approach seems to be more accurate, although the necessary data to compute the share of apportionment factors under this approach may not always be readily available in a complex tiered partnership structure. The white paper proposes converting items to absolute values to solve the problem by using a ratio of the partner’s share of partnership distributive share income when certain partners are allocated net losses while the partnership has positive net income or vice versa. However, we think this may lead to over 100% of the apportionment factors being allocated to the partners.

16. Revise the statement that fair apportionment is not entirely dependent on the unitary business principle (on page 51)

On page 51, the white paper states that, “Fair apportionment is not entirely dependent on the unitary business principle.”

The AICPA recommends that this statement should be revised as it is inconsistent with longstanding U.S. Supreme Court jurisprudence providing that, “for purposes of satisfying the Due Process Clause, ‘the linchpin of apportionability in the field of state income taxation **is the unitary-business principle** (emphasis added).” *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U. S. 425, 439 (1980); *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U. S. 207, 223 (1980); *Asarco Inc. v. Idaho State Tax Comm’n*, 458 U. S. 307, 315-320 (1982).

Moreover, we think that *Complete Auto*⁴’s quotation⁵ of *Moorman*⁶ has nothing to do with whether apportionment can be effectuated absent a unitary business relationship; but rather

⁴ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

⁵ The key quotation from *Complete Auto* that is referenced in *Moorman*, “A state tax is not per se invalid because it burdens interstate commerce. Rather, a tax will be sustained against a Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.”

⁶ *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978).

it reflects the Court’s observation that in order for there to be fair apportionment, an apportionment formula must not violate the external consistency test under the Court’s dormant Commerce Clause precedent.

The quoted language from these leading cases does not suggest in any way that fair apportionment is not dependent on the unitary business principle.

17. Remove the phrase “while not clearly required for blended apportionment” from the statement on the unitary business principle (on page 51)

On page 51, the AICPA recommends removing the italicized phrase language from the statement. “The unitary business principle, *while not clearly required for blended apportionment* (emphasis added), could nevertheless provide a kind of standard for or limit to the use of blended apportionment.”

The white paper goes further by combining apportionment factors even when the partnership is not unitary with the partner, if the partnership interest serves an operational function in the partner’s business. That disregards the U.S. Supreme Court’s clarifying language in *MeadWestvaco Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16 (2007) that “the operational function references in *Container* and *Allied-Signal* were not intended to modify the unitary business principle by adding a new apportionment ground.” See, for example, the recent Virginia Court of Appeals decision in *Virginia Dept. of Taxation v. FJ Management Inc.*, Record No. 0701-23-2 (Va. Ct. App. Nov. 12, 2024), *cert. denied*, Virginia Supreme Court (June 3, 2025), which rejected the Department of Taxation’s argument that a second, distinct ground for apportionment exists.

That creates confusion that could be burdensome for both taxpayers and tax agencies due to the lack of certainty surrounding this issue and the potential for lengthy litigation if the state’s tax assessments are challenged on constitutional grounds.