



MULTISTATE TAX COMMISSION

State Taxation of Partnerships – Status Report

OCTOBER 22, 2025

PROJECT STATUS UPDATE

Recommendations for review

Anticipation of work group decision on whether to draft model rules

Anticipation of “aligning” these rules with the special rules for investment partnerships

RECOMMENDATIONS:

1. Use **terms** consistently with partnership law and Subchapter K and define other important terms to avoid ambiguity.

(See subsection I.B., C. and D.)

RECOMMENDATIONS:

2. Recognize how the **attribution principle** may affect application of state tax rules.

(See subsection I.F.)

RECOMMENDATIONS:

3. Adopt the following sourcing **framework** for sourcing partnership income (See subsection II.A.) :

- a. The **partnership will make a determination** of whether the items of income that it recognizes directly from its own activities are **apportionable income or non-apportionable income**, using information reasonably available.

RECOMMENDATIONS:

3. Adopt the following sourcing **framework** for sourcing partnership income (See subsection II.A.) :

- b. For items which the partnership determines to be **non-apportionable**, it will then **apply state rules of assignment** to determine the source of those items, based on their character, and will report this information to partners for their use.

RECOMMENDATIONS:

3. Adopt the following sourcing framework for sourcing partnership income (See subsection II.A.) :

- c. Partnerships will also determine their apportionment factors by state and will provide information sufficient for partners to use those factors in sourcing their share of the apportionable income directly recognized by that partnership.

RECOMMENDATIONS:

3. Adopt the following sourcing framework for sourcing partnership income (See subsection II.A.) :

- d. Partners will source their share of items determined by the partnership to be non-apportionable income based on the sourcing information provided by the partnership.

RECOMMENDATIONS:

3. Adopt the following sourcing framework for sourcing partnership income (See subsection II.A.) :

- e. Partners will source their share of items determined by the partnership (or the partner) to be apportionable income either by:
 - i. Applying the partnership's apportionment factors to those items, or
 - ii. Using blended apportionment.

RECOMMENDATIONS:

4. Use **absolute value of distributive share** for determining the share of partnership factors to include in the partner's apportionment factor when blending.

(See subsection II.B.)

RECOMMENDATIONS:

5. Apply blended apportionment when there is a sufficient unitary relationship between apportionable income of the partnership and apportionable income of the partner (detailed in subsection II. B.).

(See subsection II.B.)

RECOMMENDATIONS:

6. Consider a special rule for sourcing mandatory allocations of built-in gains or losses attributed to the contributing partner—at least in some situations.

(See subsection II.C.)

7. Consider how related-entity transactions not eliminated by blended apportionment may affect the sourcing of income and adopt special rules—including add-back statutes and transfer-pricing authority.

(See subsection II.D.)

RECOMMENDATIONS:

9. When adopting more detailed rules, states should also consider limitations or exceptions that may simplify the application of state sourcing requirements to partnership income where there is little chance of abuse and where this would reduce compliance burdens.

10. Many states will also need to adopt more detailed partnership information reporting rules and forms to ensure partners have necessary information to source their distributive share.

“ALIGNING” WITH SPECIAL RULES FOR QIPS

- The special rules for qualified investment partnerships were drafted to apply a “look-through” approach in certain circumstances.
- The rules may not address fully how non-qualifying partners (active partners and corporate partners) will source their income.
- The rules may also not address how administrative expenses of the investment partnership are sourced.

ANTICIPATION OF DRAFTING MODEL RULES

- Assuming that there is consensus about the recommendations and the framework for the general approach, we can begin drafting models.
 - Models can serve as a “proof of concept.”
 - They can also highlight areas where a lack of uniformity can lead to multiple taxation, nowhere taxation, or undue complexity.

Drafting Steps

- I. Rule for use of terms – Use will be consistent with Subchapter K and state law of partnerships unless otherwise clearly indicated. Will also refer to model rules for sourcing.
- II. Rule for attribution – The attribution of the character of items under IRC 702 will also apply where the character of items determines or contributes to the determination of state tax effects—including sourcing.

Drafting Steps (cont'd)

- III. Framework: Sourcing of distributive share and guaranteed payments for services.**
 - a) Partnership level –**
 - 1) Determine apportionable and non-apportionable items**
 - 2) Apply rules of assignment (UDITPA rules of allocation) to the non-apportionable items**
 - 3) Determine apportionment factors and source apportionable income**
 - 4) Attribute source of partnership income determined at the partnership level to the partners (using results of 2 and 3) – exception where blended apportionment is applied to apportionable income**

Drafting Steps (cont'd)

5) Blended apportionment –

- A. Apply when the business or income of the partnership bears a unitary relationship with the partner's business or income.
- B. Use absolute value of the distributive share of items (including guaranteed payments) allocated to the partner to determine the partner's ratio of the factors, and eliminating the share of related-party transactions from the sales factor.

Drafting Steps (cont'd)

III. Framework: Sourcing of distributive share and guaranteed payments for services.

b) Limitations or special rules –

- 1) Clarify that federal anti-abuse rules apply where the effect is on state tax, including sourcing, rather than on the federal tax
- 2) Special rules for sourcing of built-in gains (losses) in some circumstances
- 3) Review of model add-back rule and its application to partnerships
- 4) Special rules necessary for investment partnerships
 - A. Address the application of the sourcing rules to non-active partners
 - B. Address the application of sourcing rules to the non-investment income and expense of the partnership
 - C. Address the application of sourcing rules to active/managing partners

ANTICIPATION OF DRAFTING MODEL RULES

- If there can be general consensus of the work group, considering any public comments, prior to the November uniformity committee meeting, we can ask the committee if they have any input.
- If there is agreement, we can proceed draft model rules.



QUESTIONS ON NEXT STEPS?

