



MULTISTATE TAX COMMISSION

State Taxation of Partnerships – Status Report

JANUARY 29, 2026



WHITE PAPER – JAN 29, 2026 VERSION

POSTED ON THE PROJECT PAGE



STATUS

- Received comments from the AICPA and the Energy Infrastructure Council (EIC) – posted on the project page.
- Staff discussed the comments informally with the AICPA – made some clarifications to the white paper.
- EIC is mainly concerned with the use of the absolute value method for determining the share of partnership factors to blend with the partner factors. (Also wanted that alternative sourcing of built-in gains and losses to be an anti-abuse rule – which is how it is presented in the draft model rules.)

STATUS

- We also know there are continuing questions on the application of the unitary business principle to the blended apportionment approach.
- This is also included in the draft model rules – which are a first draft for discussion purposes only.

CHANGES TO THE WHITE PAPER

See the **highlighted sections** in the January 29, 2026 version.

Consolidated information on sourcing that was previously split between Section I.E and Section II. A.

Made other non-substantive or clarifying changes throughout.

Finalized the recommendations.

Apply Sourcing Starting at the Partnership Level –

- We recommend applying sourcing rules to partnership income in complex structures the same way the rules are applied to simple partnerships – starting at the partnership level and attributing information about the income and source to the partners.

Use the Absolute Value Method for Blending –

- We recommend that when using blended apportionment, states determine the share of partnership factors to include in the apportionment formula based on the ratio of the partner's distributive share (the majority rule) and the absolute value of items.

WHAT DID NOT CHANGE

THE BIG QUESTION: WHY START AT THE PARTNERSHIP LEVEL?

- **Short answer –**

Because that's how pass-through taxation works and starting at the partner level makes it much easier to change the source of income to the partner's residence or domicile.

- **Long answer –**

Because partnerships determine critical information about the character of the income and that character is then attributed to the partners which affects the application of both the federal and state substantive tax rules. This requires that partners use the partnership information to determine their state tax result. If that information is not used, partners could more easily set up partnership structures to change the character of items and by doing so also change the source.

WHAT STARTING AT THE PARTNERSHIP LEVEL MEANS

- The partnership that first recognizes items of income, expense, gain, and loss must look to the substantive tax rules to determine the important character of the items that will have to be tracked for tax purposes and will report that information to its direct partners.
- Any tiered partners will also report the character of the items allocated to them from lower-tier partnerships in the information provided to their own direct partners.
- Partners must report their taxes consistently with this information.

WHAT STARTING AT THE PARTNERSHIP LEVEL MEANS

- This character of the partnership items may determine how sourcing rules apply.
- For example, there is no reference to “distributive share” in UDITPA’s rules for sourcing non-apportionable (nonbusiness) income. Nor is distributive share a “dividend” as some have mistakenly argued. Rather, the sourcing rules depend on the character of the individual items which is attributed to the partners.

WHAT STARTING AT THE PARTNERSHIP LEVEL DOES NOT MEAN

- It does NOT mean that the partner's attributes will never have any bearing on the state tax result.
 - Example – Individuals and corporations are taxed under somewhat different systems.
- It does NOT mean that the partner's business activities can never affect the sourcing of the partnership income.
 - Example – Blended apportionment will typically apply when the partner's business activities and the partnership activities are sufficiently related.

WHAT ABOUT THE BIG “HOW” QUESTION FOR BLENDING?

- How should the share of factors be determined?
 - Not by capital accounts – since they do not control the income or items allocated to partners.
 - Not by a “partner’s interest in the partnership” – since this term can be more complicated to apply unless allocations have been determined to lack substantial economic effect.
 - Not on an item-by-item basis – since partners often receive special allocations of expenses for which there are not related receipts.

WHAT ABOUT THE BIG “HOW” QUESTION FOR BLENDING?

- Using the partner’s distributive share of partnership income.
 - The problem is when there are special or mandatory allocations that may make this impossible to compute (as where the partner’s distributive share is negative while the partnership income is positive, or vice versa).
 - This is where the absolute value method comes into play.

Partnership Items (Actual Value)	Total	Partner A Share	Partner A Share	Partner B Share	Partner B Amount
Gross Receipts from Activity A	\$ 100,000	80.00%	\$ 80,000	20.00%	\$ 20,000
Direct Expenses related to Activity A	\$ (50,000)	80.00%	\$ (40,000)	20.00%	\$ (10,000)
Gross Receipts from Activity B	\$ 200,000	20.00%	\$ 40,000	80.00%	\$ 160,000
Direct Expenses related to Activity B	\$ (120,000)	20.00%	\$ (24,000)	80.00%	\$ (96,000)
Depreciation Expense	\$ (50,000)	20.00%	\$ (10,000)	80.00%	\$ (40,000)
Rental of Real Property Expense	\$ (40,000)	50.00%	\$ (20,000)	50.00%	\$ (20,000)
Loss on Sale of Assets	\$ (20,000)	100.00%	\$ (20,000)	0.00%	\$ -
Total Partnership Income	\$ 20,000		\$ 6,000		\$ 14,000
Partner's Share of Factors			30%		70%
Partnership Items (Absolute Value)	Total	Partner A Share	Partner A Amount	Partner B Share	Partner B Amount
Gross Receipts from Activity A	\$ 100,000	80.00%	\$ 80,000	20.00%	\$ 20,000
Direct Expenses Related to Activity A	\$ 50,000	80.00%	\$ 40,000	20.00%	\$ 10,000
Gross Receipts from Activity B	\$ 200,000	20.00%	\$ 40,000	80.00%	\$ 160,000
Direct Expenses Related to Activity B	\$ 120,000	20.00%	\$ 24,000	80.00%	\$ 96,000
Depreciation Expense	\$ 50,000	20.00%	\$ 10,000	80.00%	\$ 40,000
Rental of Real Property Expense	\$ 40,000	50.00%	\$ 20,000	50.00%	\$ 20,000
Loss on Sale of Assets	\$ 20,000	100.00%	\$ 20,000	0.00%	\$ -
Total Partnership Income (Absolute Value)	\$ 580,000		\$ 234,000		\$ 346,000
Partner's Share of Factors			40%		60%

Partnership Items (Actual Value)	Total	Partner A Share	Partner A Share	Partner B Share	Partner B Amount
Gross Receipts from Activity A	\$ 100,000	80.00%	\$ 80,000	20.00%	\$ 20,000
Direct Expenses related to Activity A	\$ (50,000)	80.00%	\$ (40,000)	20.00%	\$ (10,000)
Gross Receipts from Activity B	\$ 200,000	20.00%	\$ 40,000	80.00%	\$ 160,000
Direct Expenses related to Activity B	\$ (140,000)	20.00%	\$ (28,000)	80.00%	\$ (112,000)
Depreciation Expense	\$ (50,000)	20.00%	\$ (10,000)	80.00%	\$ (40,000)
Rental of Real Property Expense	\$ (40,000)	50.00%	\$ (20,000)	50.00%	\$ (20,000)
Loss on Sale of Assets	\$ (20,000)	100.00%	\$ (20,000)	0.00%	\$ -
Total Partnership Income	\$ -		\$ 2,000		\$ (2,000)
Partner's Share of Factors			#DIV/0!		#DIV/0!
Partnership Items (Absolute Value)	Total	Partner A Share	Partner A Amount	Partner B Share	Partner B Amount
Gross Receipts from Activity A	\$ 100,000	80.00%	\$ 80,000	20.00%	\$ 20,000
Direct Expenses Related to Activity A	\$ 50,000	80.00%	\$ 40,000	20.00%	\$ 10,000
Gross Receipts from Activity B	\$ 200,000	20.00%	\$ 40,000	80.00%	\$ 160,000
Direct Expenses Related to Activity B	\$ 140,000	20.00%	\$ 28,000	80.00%	\$ 112,000
Depreciation Expense	\$ 50,000	20.00%	\$ 10,000	80.00%	\$ 40,000
Rental of Real Property Expense	\$ 40,000	50.00%	\$ 20,000	50.00%	\$ 20,000
Loss on Sale of Assets	\$ 20,000	100.00%	\$ 20,000	0.00%	\$ -
Total Partnership Income (Absolute Value)	\$ 600,000		\$ 238,000		\$ 362,000
Partner's Share of Factors			40%		60%



DRAFT MODEL RULES

POSTED ON THE PROJECT PAGE





KEEP IN MIND

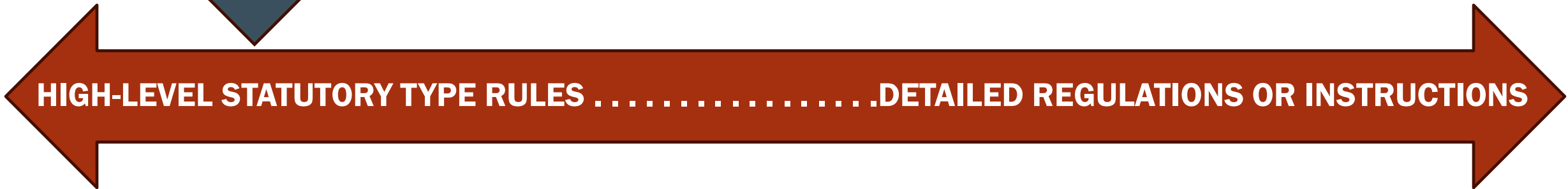
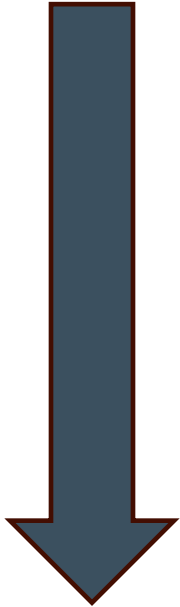
- **States have partnership rules now that may use different terms and are typically spread out and embedded in the corporate and individual income tax rules.**
- **Some states will have more partnership-related rules in place currently than others. (See the White Paper Section III.)**

HOW TO THINK OF THE DRAFT RULES

- The rules for sourcing of partnership income where there are tiered and corporate partners.
- A first draft (subject to change).
- A “mini-Subchapter K” for state purposes.
 - It’s fairly short, just like Subchapter K.
 - It’s fairly general, just like Subchapter K.
 - It addresses partnership-specific issues and references the substantive tax rules, just like Subchapter K.
 - It contains anti-abuse rules, just like Subchapter K

HOW TO THINK OF THE DRAFT RULES

- Useful input at this point is to what extent there needs to be more detail (e.g., examples, rules for specific situations, etc.).
- This has to be balanced with the need for consensus on the general approach.



HIGH-LEVEL STATUTORY TYPE RULESDETAILED REGULATIONS OR INSTRUCTIONS

ONE OTHER THING TO KEEP IN MIND

- 90% of partnership taxation is information reporting by the partnerships—to the partners and to the taxing authority.
- Practitioners often talk about the difficulty of reporting information in the partnership context.
- Traditional tax forms have been automated, but sometimes this “oversimplifies” the reporting or removes information essential in certain circumstances.
- So an important part of making this system work will be the way in which information is reported to the tax agency and to partners.



QUESTIONS ON NEXT STEPS?

