



May 21, 2026

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Taxation of Partnerships  
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Re: [Multistate Tax Commission Sourcing of Partnership Income Combined Draft Model Provisions and Recommendations](#)

Dear Ms. McElhatton, Ms. Stosberg, and Ms. Hecht:

The American Institute of CPAs (AICPA) appreciates the opportunity to provide comments on the Multistate Tax Commission's (MTC) [sourcing of partnership income combined draft model provisions & recommendations](#) ("model provisions"), dated April 15, 2026. The model provisions are part of the MTC's landmark Project on the [State Taxation of Partnerships](#) ("work group").

The model provisions combine previously circulated MTC draft model provisions and recommendations for applying state sourcing rules to:

- Distributive share income of tiered and corporate partners;
- Guaranteed payments to individuals for services; and
- Income of investment partnerships.

The AICPA previously submitted a comment letter in response to the MTC draft model act on the treatment of investment partnership income, dated August 18, 2022.<sup>1</sup> We appreciate the adoption of our recommendations in later drafts and have no further comments on the investment partnerships model act as incorporated into the model provisions.

The AICPA supports legislative and administrative efforts promoting certainty, simplicity, fairness and effectiveness, consistent with our [guiding principles of good tax policy](#) for taxpayers and tax practitioners.<sup>2</sup> The AICPA urges the MTC to convert its model provisions into a model act rather than relying on the states to issue administrative rules. These subjects are best addressed by comprehensive legislation, particularly the implementation of Anti-Abuse Rules, and legislative review of existing statutes or policies that may need to be amended or repealed in their entirety.<sup>3</sup>

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<sup>1</sup> AICPA letter, "[Draft Model Act on the Treatment of Investment Partnership Income](#)," September 12, 2022.

<sup>2</sup> See AICPA, [AICPA Guiding Principles of Good Tax Policy](#), March 2025.

<sup>3</sup> Treas. Reg. § 1.701-2.

The AICPA offers two sets of recommendations for the model provisions. First, we restate two general recommendations previously submitted in our comment letters, as they remain foundational for state tax sourcing of partnership income.<sup>4</sup>

General comments:

- I. Apply the unitary business principle to partnership income sourcing
- II. Include the decision in *Rawat v. Comm’r* with section 751 in the model provisions

Second, the AICPA offers the following specific recommendations for the model provisions.

Specific comments:

- I. “Before Reviewing the Draft Provisions” (Page 3)
  1. Replace the language regarding “Application of the unitary business principle to partnerships is unclear” (Page 4)
  2. Replace the language regarding “As with partnership taxation generally, information reporting is essential” (Page 4)
- II. “Sourcing of Partnership Income by Tiered and Corporate Partners” (Page 6)
  1. Modify “Part I: Definitions of Terms” (Page 6)
  2. Modify “Part II: Conformity to Federal Tax Rules, Including Internal Revenue Code (IRC) Subchapter K” (Page 8)
    - A. Modify the language regarding “Conformity to Federal Tax Rules, Including IRC Subchapter K” (Page 8)
  3. Modify “Part III: Obligations of Partnerships to File Information Returns and Report Information” (Page 9)
    - A. Limit the requirement to gather and report overly broad partner information
    - B. Address throwback sales in partnership information reporting

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<sup>4</sup> AICPA letter, [“MTC Draft White Paper on State Tax Sourcing of Partnership Income & the Blended Apportionment Method \(draft dated May 19, 2025\),”](#) June 16, 2025; AICPA letter, [“MTC Draft White Paper on State Tax Sourcing of Partnership Income Under the Pass-through Tax System & the Blended Apportionment Method, dated August 15, 2025,”](#) November 19, 2025.

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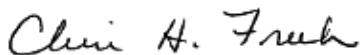
4. Modify "Part IV: Sourcing of Partnership Income and Items" (Page 10)
  - A. Allow reasonable methods for sourcing partnership income and items
  - B. Clarify the applicable sourcing rules for partnership income
- III. "Sourcing of Guaranteed Payments for Services and Additional Credit for Taxes Paid to Other States" (Page 15)
  1. Modify "Part I: State Sourcing and Taxation of Certain Guaranteed Payments"
    - A. Avoid double counting of guaranteed payments

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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 State and Local Tax TRP, at (317) 208-2478 or [Brian.Myers@crowe.com](mailto:Brian.Myers@crowe.com); Ning Yim, AICPA Senior Manager, Tax Policy & Advocacy, at (202) 434-9201 or [Ning.Yim@aicpa-cima.com](mailto:Ning.Yim@aicpa-cima.com); or me at (610) 217-4495 or [CheriFreeh@gmail.com](mailto:CheriFreeh@gmail.com).

Sincerely,



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

Encl.

American Institute of CPAs  
Multistate Tax Commission Sourcing of Partnership Income Combined Draft Model Provisions  
and Recommendations  
May 21, 2026

## Background

In April 2021, the MTC Uniformity Committee approved a project on the state taxation of partnerships based on recommendations from its Standing Subcommittee.<sup>5</sup> The project was proposed by a compact member state and is overseen by a work group composed of member states.

The project focuses on several key areas, including:

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

The MTC Uniformity Committee undertook this project for several stated reasons. First, partnerships account for a substantial and growing share of total business net income nationwide. In addition, the business landscape has evolved to include significantly larger, multi-tiered, and complex partnership structures than in prior years. Finally, because states generally conform to the federal pass-through tax regime under Subchapter K of the Internal Revenue Code (IRC), the interaction between federal partnership tax rules and state income tax systems adds considerable complexity to state tax reporting, computation, and administration.

In addition to the model provisions, the MTC issued state tax sourcing of partnership income under the pass-through tax system and the blended apportionment method (“white paper”).<sup>6</sup>

The AICPA has collaborated with the MTC throughout this project by submitting comments on various MTC partnership project issues. We appreciate the opportunity to provide comments on the model provisions and value the MTC’s efforts to promote uniformity and clarity related to the state income taxation of partnerships. The AICPA looks forward to continuing to work with the MTC on this and future initiatives.

In response to the MTC State Taxation of Partnerships project, the AICPA has previously submitted two comment letters for the white paper providing recommendations on state tax sourcing of partnership income under the pass-through tax system & the blended apportionment method.<sup>7</sup> The AICPA encourages the MTC to reconsider these recommendations, as they

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<sup>5</sup> [MTC State Taxation of Partnership Project](#).

<sup>6</sup> [Revised White Paper on Sourcing of Partnership Income](#).

<sup>7</sup> AICPA letter, [“MTC Draft White Paper on State Tax Sourcing of Partnership Income & the Blended Apportionment Method \(draft dated May 19, 2025\),”](#) June 16, 2025; AICPA letter, [“MTC Draft White Paper on State Tax Sourcing of Partnership Income Under the Pass-through Tax System & the Blended Apportionment Method, dated August 15, 2025,”](#) November 19, 2025.

remain foundational to both white paper and model provisions. The following general recommendations were included in our prior comments.

## General comments

### I. Apply the unitary business principle to partnership income sourcing

#### Recommendation

The AICPA recommends that it be confirmed in both the MTC white paper and commentary to the model provisions that the unitary business principle (UBP) applies to partnership income sourcing.

#### Rationale

Per *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, “The linchpin of apportionability in the field of state income taxation is the unitary-business principle.”<sup>8</sup> This concept applies both in the corporate and partnership context. There should be a threshold question in the sourcing rule to determine whether a partnership is engaged in a trade or business to determine the proper characterization of income at the partnership level as business or nonbusiness income. In other words, the question is whether the income is generated from activities of the taxpayer’s trade or business. The partner would then determine whether the partner’s share of income from the partnership is business (apportionable) or non-business (allocable) based on the partner’s relationship to the partnership (i.e., whether the partner and partnership are unitary) and/or the partner’s relationship to the income-generating activity. For many states, if a unitary relationship exists, then combined apportionment is required. Otherwise, partnership income is separately allocated.

In this regard, *MeadWestvaco Corp. v. Illinois Dept. of Revenue* is relevant to the extent it held the income at issue, gain on the sale of a division, must be part of a unitary business before it may be taxed by Illinois.<sup>9</sup> States may treat partnerships as separately apportionable businesses in the same way that states treat corporations or divisions as separate businesses, even when the partnerships are part of a unitary business group. The states may not, however, treat partnerships as combinable in a single apportionment, absent evidence of a unitary relationship, any more than the states can do so for a corporation.

### II. Include the decision in *Rawat v. Comm’r* with section 751 in the model provisions

#### Recommendation

The AICPA recommends including the recent DC Circuit Court decision in *Rawat v. Commissioner of Internal Revenue* (“*Rawat v. Comm’r*”) regarding the appropriate law for determining the character of a partner’s gain on disposition of their interest in the partnership.<sup>10</sup>

#### Rationale

It would be beneficial to note in the model provisions that the decision in *Rawat v. Comm’r*, which states that section 751 does not serve to distinguish business versus non-business

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<sup>8</sup> *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980).

<sup>9</sup> *MeadWestvaco Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16, 24–25 (2008).

<sup>10</sup> *Rawat v. Commissioner of Internal Revenue*, No. 23-1142 (D.C. Cir., July 23, 2024).

income, also applies for state income tax purposes.<sup>11</sup> The decision mentions aggregate versus entity theory analysis as well.

In addition, the California Franchise Tax Board Legal Ruling 2022-02 states that section 751 ordinary income automatically results in that income being treated as business income for California franchise tax purposes, which calls for different sourcing rules than those applicable when the entire gain on the disposition of a partnership interest is treated as capital gain sourced to the partner's state. The model provisions conflict with the purpose served by section 751 (to cause some of the partner's gain to be treated as ordinary income rather than as capital gain) and the DC Circuit's conclusion in *Rawat v. Comm'r*. It would be helpful for the work group to take a position in line with the *Rawat v. Comm'r* case, stating that section 751 is not applicable in identifying when a partner's gain on the sale of an interest in a partnership is business income or non-business income for state income tax purposes.

The AICPA offers the following specific recommendations for the model provisions. Our comments below include italicized text for new or revised text.

#### Specific comments:

- I. "Before Reviewing the Draft Provisions" (Page 3)
  1. Replace the language regarding "Application of the unitary business principle to partnerships is unclear" (Page 4)

#### Issue

The current language "Application of the unitary business principle to partnerships is unclear," does not clearly explain why the application of the unitary business principle to partnerships is unclear and contains several issues that undermine its effectiveness. It states that the U.S. Supreme Court has "never applied the general criteria of the unitary business principle to a case involving the sourcing of partnerships distributive share," while also asserting that the application of those criteria is not clear.

#### Recommendation

The AICPA recommends replacing the following model provision language "Application of the unitary business principle to partnerships is unclear," with the following language:

*"Although a number of state appeals courts and state taxing authorities have applied the unitary business principle to a case or fact pattern involving the sourcing of partnership distributive share, and in classifying the gain on the sale of a partnership interest, the U. S. Supreme Court has not made it clear how those criteria would apply to partners and partnerships (which have different legal relationships than corporations and subsidiaries). For example, some states have recognized that ownership, often used to determine control for corporate entities, does not determine control of partnerships - where minority partners often exercise control."*

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<sup>11</sup> 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.

## Rationale

The recommended language is intended to acknowledge the need for a careful and specific analysis when applying the UBP to partnership interests rather than creating unsubstantiated doubt as to whether the UBP applies to partnerships at all.

2. Replace the language regarding “As with partnership taxation generally, information reporting is essential” (Page 4)

## Issue

The current language “As with partnership taxation generally, information reporting is essential,” could be interpreted as granting tax agencies unlimited discretion to demand information, without regard to relevance or the compliance burden. As a result, partnerships may be required to obtain, then provide expansive or unnecessary information, increasing both compliance costs and administrative burdens, including subjecting them to heavy penalties if they are unable to obtain this information.

## Recommendation

The AICPA recommends replacing the following model provision language “As with partnership taxation generally, information reporting is essential,” with the following language:

“While the draft provisions do not address specifically how partnerships will report *direct* or *indirect* partner information, they provide state tax agencies with the authority to *reasonably* require necessary information *gathering and* reporting.”

## Rationale

The recommended language is intended to underscore that state tax agencies should exercise their discretion in a reasonable manner that promotes simplicity, and administrative effectiveness, while minimizing unnecessary compliance burdens for taxpayers and their advisers.

- II. “Sourcing of Partnership Income by Tiered and Corporate Partners” (Page 6)
  1. Modify “Part I: Definitions of Terms” (Page 6)

## Issue

Various terms used in the model provisions are not clearly defined, creating ambiguity in how the provisions are to be interpreted and applied. The lack of clear definitions increases uncertainty for both taxpayers and tax administrators and may result in inconsistent application across taxing jurisdictions.

## Recommendations

The AICPA recommends the following edits to the definitions of certain terms in the model provisions:

- A. Add “*of*” before “income” in the first bullet point to clarify the phrase as “Allocate or allocation of distributive share *of* income or items.”

- B. Add “*state’s*” before “apportionment” in the second bullet point to clarify the sentence as follows: “Income or items that are included in net taxable income sourced using a particular *state’s* apportionment formula related to that net income.”
- C. Insert “*by a partner*” before “to or distributed,” and add “*to another partner*” at the end of the fourth bullet point to clarify the sentence as follows: “The amount of an item’s fair market value as compared to its tax basis at a particular point in time - including the point at which the item is contributed *by a partner* to or distributed from a partnership *to another partner*.”
- D. Insert “*income*” before “tax treatment” in the fifth bullet point to clarify the sentences as follows: “The nature of items which may affect their *income* tax treatment as determined by a partnership applying general substantive federal or state tax law based on the activity giving rise to the item.”
- E. Insert “*in whole or in part*” before “a return of the partner’s capital” in the eighth bullet point to clarify the sentence as follows: “Items including cash or property transferred by a partnership to a partner that represent, *in whole or in part*, a return of the partner’s capital.”
- F. Remove “partner or” before “owner,” change “a” to “*an*,” and replace “partnership” with “*pass-through entity*” in the tenth bullet point to clarify the sentence as follows: “*An* owner of a *pass-through entity* that, itself, owns an interest in another *pass-through entity*.”
- G. Add “*a*” before “particular states,” remove the “s” from “states,” and add “*rather than apportioned in part to the taxing state*” at the end of twelfth bullet point to clarify the sentence as follows: “Income or items that are assigned (or allocated) to a particular state *rather than apportioned in part to the taxing state*.”
- H. Replace “taxed as a partner” with “*as a member of a partnership*,” and add “*income tax*” before “law” in the thirteenth bullet point to clarify the sentence as follows: “A person, whether an individual, corporation, or other entity *as a member of a partnership* under federal *income tax* law, including direct and indirect partners.”
- I. Add “*income tax*” before “law,” add “*and also taxed as a partnership under a particular state’s income tax law*” after “limited liability companies, etc.” and add “*Entities that have validly elected under a state’s so-called pass-through entity tax (PTET) law to become a so-called PTE or flow-through entity, taxable by the state at the entity level, are not considered partnerships for this purpose, and are not subject to this act nor are their owners in their capacity as such,*” at the end in the fourteenth bullet point to clarify the sentences as follow: “An entity taxed as a partnership under federal *income tax* law including general partnerships, limited partnerships, limited liability companies, etc., *and also taxed as a partnership under a particular state’s income tax law*. See IRC §§ 761(a) and 7701 and related regulations. *Entities that have validly elected under a state’s so-called pass-through entity tax (PTET) law to become a so-called PTE or flow-through entity, taxable by the state at the entity level, are not considered partnerships for this purpose, and are not subject to this act nor are their owners in their capacity as such.*”

- J. Add “*income*” before “tax” in the fifteenth bullet point and delete “general” in reference to the state’s partnership law to clarify the sentence as follows: “The agreement between the partners generally or on particular partnership matters, regardless of form, as the term is used for federal *income* tax purposes and consistent with state partnership law.”
- K. Add “§” after “See Treas. Reg.” in the sixteenth bullet point as follows: “See Treas. Reg. § 1.6031(a)-1 and IRS Form 1065.”
- L. Remove “state or” after “general,” remove “substantive” after “federal,” add “*or the relevant state’s income*” before “tax law,” and add “s” after “law,” in the seventeenth bullet point to clarify the sentence as follows: “Any tax-significant result generated from a transaction, activity, or event including income, expense, gain, loss, etc. that is recognized and given particular treatment under the general federal *or the relevant state’s income* tax laws.”
- M. Add “*or items of income*” after “allocate income” in the nineteenth bullet point to clarify the sentence as follows: “The method used to source or allocate income *or items of income* to under [REFERENCE(S) TO STATE STATUTORY PROVISIONS FOR SOURCING NON-APPORTIONABLE OR “NONBUSINESS” ITEMS OF INCOME.]”
- N. Add “*or partner*” after “particular taxpayer” in the twenty-first bullet point to clarify the sentence as follows: “An aspect of a particular taxpayer *or partner* that may affect the ultimate tax result for items recognized by or attributed to that taxpayer or partner, which may include:”
- O. Add “*to be*” after “are,” and “*income*” before “tax law” in the B bullet point to clarify the sentence as follows: “Other terms not defined above are *to be* interpreted consistently with the context and with applicable state and federal *income* tax law.”

## Rationale

The recommended edits to the definitions of terms above are intended to address inconsistency and ambiguity resulting from the use of the same or similar terms across the three general bodies of law referenced in the model provisions:

- General state law governing partnerships;
- Federal income tax law; and
- General state tax law.

The recommended modifications promote greater uniformity and clarity by providing consistent, aligned definition of terms for taxpayers and tax practitioners, facilitating more effective tax compliance and administration.

2. Modify “Part II: Conformity to Federal Tax Rules, Including Internal Revenue Code (IRC) Subchapter K” (Page 8)
  - A. Modify the language regarding “Conformity to Federal Tax Rules, Including IRC Subchapter K” (Page 8)

### Issue

The current language does not contain the word “income,” which makes the scope of conformity unclear and could be interpreted as extending beyond federal income tax law. It also weakens the link to Subchapter K, which is grounded in federal income tax principles.

### Recommendation

The AICPA recommends modifying the language regarding “Conformity to Federal Tax Rules, Including IRC Subchapter K,” by replacing the current language in the model provisions with the following:

“Conformity to Federal *Income* Tax Rules, Including IRC Subchapter K”

“[STATE] conforms to the federal *income* tax law, including IRC Subchapter K, as provided in [REFERENCE(S) TO STATE LAW THAT AFFECTS CONFORMITY FOR CORPORATE AND INDIVIDUAL TAXPAYERS]. In conforming to Subchapter K, [STATE] also *conforms* to the principle that *the* tax character of *certain* items of income *and loss is determined at the partnership level* and then *attributed* to the partners who receive a distributive share of those items. This character as determined *at the partnership level* may affect the state *income* tax treatment of the items under the state *income* tax rules, including the sourcing of those items under [REFERENCE(S) TO STATE LAW FOR SOURCING INCOME - INCLUDING CORPORATE AND INDIVIDUAL SOURCING RULES].”

### Rationale

A key drafting challenge is that states typically address corporate and individual income taxes in separate statutory sections or chapters, while placing partnership-related provisions, including sourcing rules, within both frameworks. The recommended language is intended to provide a consistent and administrable approach to sourcing partnership income by tiered and corporate partners, promoting uniformity and reducing uncertainty.

3. Modify “Part III: Obligations of Partnerships to File Information Returns and Report Information” (Page 9)
  - A. Limit the requirement to gather and report overly broad partner information

### Issue

The model provisions include a requirement for partnerships to gather and provide partner-level information for any state in which the partnership has a “direct or indirect partner doing business in or resident in...” This requirement is overly broad and would create significant and unnecessary burdens for businesses, particularly small and mid-sized partnerships, and their

tax advisers. It also implies that states may exert nexus over a partnership if even one of its direct or indirect partners resides or is domiciled in that state.

## Recommendation

The AICPA recommends limiting the requirement in Part III, Subpart A of the model provisions stating that partnerships must obtain and provide to the state tax agency certain partner level information for any state in which the partnership has a “direct or indirect partner doing business in or resident in.”

## Rationale

Generally, partnerships do not have a reliable means of determining where all direct, and indirect, partners are conducting business, nor do they have visibility into the residency of indirect partners throughout complex, multi-tiered ownership structures.

As illustrated in Attachment 1 of this letter, which provides an example of a typical partnership ownership structure, these complexities make it exceedingly difficult for partnerships to obtain and provide to a state tax agency complete and accurate partner-level information. For additional clarity, Attachment 1 assumes Operating LLC that does business in Indiana and in several other states, and is owned by 2 members: Operating Inc. and Holdings, LLC. Holdings, LLC is a multi-member LLC and does business in Indiana and several other states in the real estate industry. And 2 members of Holdings, LLC are also multi-member LLCs that in turn do business in some of the same states and in others as well, in the tourism industry. Assume that all LLCs are classified as partnerships for state income tax purposes.

The model provisions’ definition of “indirect partner,” coupled with the overbroad information-gathering requirements in Subpart A, would sweep in the real estate Holdings, LLC and the members of the next tier tourism LLC, etc. It would be impossible to secure the information that Subpart A would require Operating LLC to gather from the upper tier LLCs, and hold for state tax agency auditors. Furthermore, we would expect the managers of the upper tier LLCs to refuse to provide this information or to simply ignore the request as they would not likely be under any legal obligation to provide it.

Reporting obligations that depend on information that is often unavailable or unobtainable undermine simplicity and administrability, and they do not represent an effective or workable approach for partnerships or state tax administrators.

## B. Address throwback sales in partnership information reporting

### Issue

The model provisions require a partnership to provide to the state tax agency “any information” the agency deems necessary to verify the information reported to partners under Subpart A, as directed through regulations, forms, or instructions. This requirement is overly broad and effectively grants open-ended authority to the state tax agency to require additional information without clear parameters or limitations. In particular, the provision does not appear to contemplate how throwback sales should be determined in a partnership context.

## Recommendation

The AICPA recommends that the model provisions clarify how throwback sales should be addressed in the sourcing of partnership income by tiered and corporate partners, and limit partnership reporting obligations accordingly.

## Rationale

Throwback determinations must first be made at the partnership level and then, where appropriate, redetermined at the partner level if the partner is unitary with the partnership. For example, a California partnership ships tangible personal property to Indiana but is protected under P.L. 86-272 and therefore has no Indiana filing obligation. At the partnership level, those receipts are properly assigned to California under California law. However, if a corporate partner is unitary with the partnership and has additional Indiana activities that void P.L. 86-272 protection, the same receipts may be required to be sourced to Indiana at the partner level. This resourcing depends on facts and activities that are unique to the partner and may not be known, or even knowable, by the partnership.

Clear guidance recognizing the distinction between partnership level and partner level analyses would promote simplicity, administrability, and consistent application, while ensuring that throwback sourcing is determined at the appropriate level based on available and relevant information and avoids double taxation.

### 4. Modify “Part IV: Sourcing of Partnership Income and Items” (Page 10)

#### A. Allow reasonable methods for sourcing partnership income and items

## Issue

The model provisions suggest use of the absolute value method to source apportionable income of a partnership that is also part of the partner’s own apportionable income. This will determine the share of partnership factors to include the share of total partnership distributive share income allocated to that partner. This approach is intended to address situations involving special allocations, but introduces unnecessary complexity and uncertainty regarding how a partner’s economic interest is reflected in the apportionment factors.

## Recommendation

The AICPA recommends against mandating the absolute value method for allocating partnership factors to partners. Instead, partnerships should be permitted to use any reasonable method that fairly reflects the partner’s economic interest in the partnership, particularly where special allocations are present. Reasonable alternatives could include an item-by-item approach based on the special allocation percentages applicable to each item or, more simply, the partner’s overall profit or loss percentage. For property factors, a capital percentage may be more appropriate, as it better reflects a partner’s share of partnership assets.

## Rationale

The absolute value method is overly complex, rarely used, and does not necessarily produce a percentage that is representative of a partner’s true economic interest in the partnership. In practice, using income percentages for sales and payroll, and loss percentages only in cases of

overall loss, has proven to be both administrable and conceptually sound, while property factors are more accurately reflected through capital-based measures.

Allowing flexibility to apply reasonable, fact-based methods would reduce compliance burdens, better align factor representation with economic reality, and support consistent and effective application without imposing an approach that is overly burdensome.

## B. Clarify the applicable sourcing rules for partnership income

### Issue

The model provisions refer to the application of the state's sourcing rules when computing partnership income allocable to nonresident partners and/or for purposes of a composite return, but they do not specify whether corporate sourcing rules or nonresident individual sourcing rules should apply.

### Recommendation

The AICPA recommends that the model provisions clarify that corporate sourcing rules, rather than nonresident individual sourcing rules, are intended to apply when computing partnership income allocable to nonresident partners and/or for purposes of a composite return.

### Rationale

Many states apply corporate sourcing rules when determining the sourcing of partnership income, even when the partners are individuals, recognizing that partnerships frequently operate as business entities rather than pass-throughs of passive investment income. Explicitly identifying the applicable sourcing regime as the corporate sourcing rules would promote uniformity, reduce the risk of inconsistent application across states, and simplify compliance for partnerships responsible for computing nonresident and composite tax. This approach illustrates the importance of clear statutory rules, along with a corresponding repeal of inconsistent sourcing rules in the existing state statutes and/or regulations.

## III. "Sourcing of Guaranteed Payments for Services and Additional Credit for Taxes Paid to Other States" (Page 15)

### 1. Modify "Part I: State Sourcing and Taxation of Certain Guaranteed Payments"

#### A. Avoid double counting of guaranteed payments

### Issue

The model provisions do not specifically address the risk of double counting guaranteed payments, an omission that can lead to a common and significant sourcing error. Without explicit guidance, guaranteed payments may be inadvertently included both in the partnership's apportionable business income and again as separately sourced income to the partner, resulting in duplicative treatment of the same income.

### Recommendation

The AICPA recommends that the model provisions include explicit language addressing the sourcing of guaranteed payments to avoid double counting and taxing of guaranteed payments.

Guaranteed payments should be excluded from ordinary business income before distributive shares are determined, ensuring that the same income is not included both in the partnership's apportioned business income and again as a separately sourced payment. The guaranteed payments can then be sourced independently using the partnership's apportionment factor.

### Rationale

Clarifying the state income tax treatment of guaranteed payments promotes certainty and consistency in the application of the model provisions by reducing ambiguity that can lead to double counting. Excluding guaranteed payments from ordinary business income before allocating distributive shares simplifies compliance and administration for both taxpayers and state tax authorities. Sourcing guaranteed payments separately ensures that income is sourced only once, resulting in a fairer and more accurate outcome that aligns with the economic substance of the payments.

# Attachment 1 Typical Structure

