State Taxation of Partnerships – Examples of treatment from Model statutes

MAY 20, 2026

COMBINED MODEL PROVISIONS – STATE SOURCING

- Summary – General Rules
  - Start at the partnership that first recognizes the income for tax purposes.
  - Determine tax character of partnership items – including whether they are apportionable or non-apportionable based on the partnership's information and activities.
  - Determine related apportionment factors.
  - Capture and report necessary information to all direct partners to allow them to comply with state sourcing rules applied to income of businesses.

COMBINED MODEL PROVISIONS – STATE SOURCING

- Summary – General Rules
  - For tiered and corporate partners – determine if partnership items allocated directly from partnership are part of a unitary business in which the partner participates.
  - If so, apply blending – using the distributive share to determine the share of partnership factors to include in the partner's formula, and applying the absolute value method if necessary.
  - Comply with all pass-through anti-abuse rules applied to prevent change in the character or source of income.

COMBINED MODEL PROVISIONS – STATE SOURCING

- Summary – Guaranteed Payments for Services
  - Sourced in the same way as that partner's distributive share would be sourced. (See the general rules.)
  - Generous credit for taxes paid for residents taxed in another state on the same guaranteed payment based on location of services.

COMBINED MODEL PROVISIONS – STATE SOURCING

- Summary – Exception for Income of Investment Partnerships
  - Applies only to nonresident individual partners (or persons taxed as nonresidents) who are not active in the investment partnership.
  - The activities of the investment partnership (as defined) will not affect the sourcing of income from the investments.
  - Rather, the partners will source the income from the investments as though they held the assets directly.

COMBINED MODEL PROVISIONS – INFORMATION REPORTS

- Part III of the model.
  - A partnership shall provide to its direct partners the information necessary for its direct and indirect partners to properly compute and report their [STATE] tax. Necessary information includes any information as described or provided for in regulations, forms, and instructions issued by the [STATE TAX AGENCY]. This requirement to provide information applies to:
    - 1. Any partnership doing business in [STATE];
    - 2. Any partnership that has a direct or indirect partner doing business in or resident in [STATE].
    - 3. Any partnership that has a direct or indirect interest in a partnership doing business in [STATE].

COMBINED MODEL PROVISIONS – INFORMATION REPORTS

- Summary – Downstream Flow of Information (Partner to Partnership)
  - Any partnership doing business in a state needs to know the status of its partners to comply with sourcing state laws, such as withholding or PTE taxes.
  - Any partnership that has a direct or indirect partner doing business in or resident in a particular state must know what this partner needs to comply with the residence state laws, such as state modifications.

COMBINED MODEL PROVISIONS – INFORMATION REPORTS

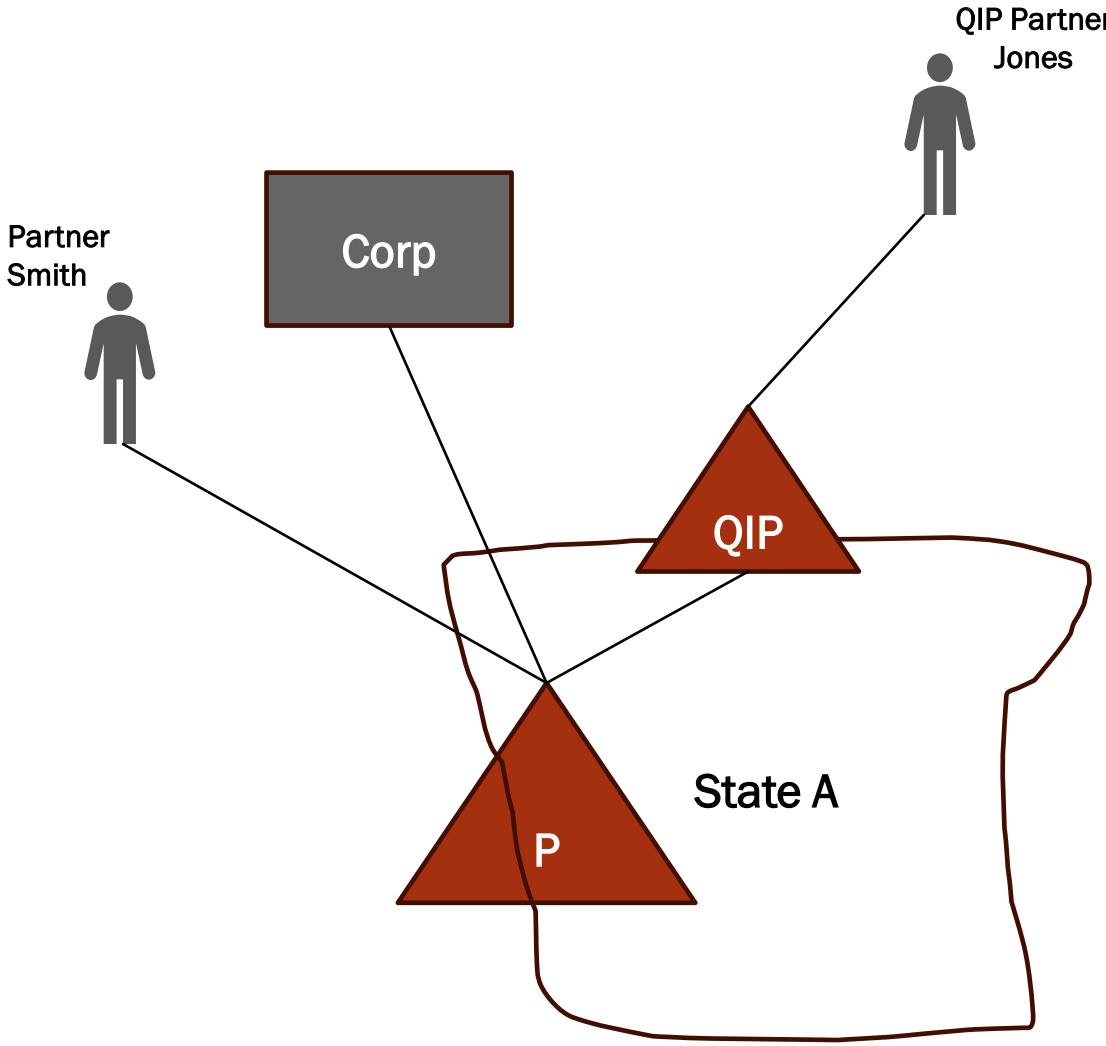
- Summary – Upstream Flow of Information (Partnership to Partner)
  - Any partnership doing business in a state, or that has a direct or indirect interest in a partnership doing business in a state, must file state information returns and Schedules K-1 for each partner receiving distributive shares.
  - Any partnership that has a direct or indirect partner doing business in or resident in a particular state must provide its direct or indirect partners information allowing that partner to comply with the laws of its residency state, provided the partnership received the downstream information.

REMARKS

- Upstream information is the most formalized. (Schedule K-1).
- Downstream information is information necessary for the management of the partnership.
- The model is recalling a requirement to transmit downstream information that is necessary for the application of source and residence states tax laws.
- The quantity of upstream information needed is far greater than the quantity of downstream information.

COMBINED MODEL PROVISIONS – INFORMATION REPORTS

Examples

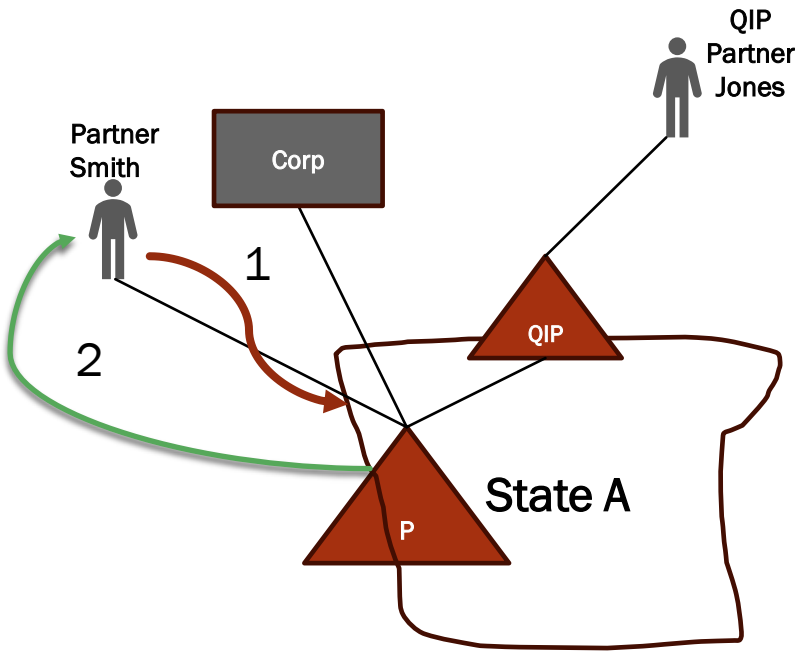


General Assumptions:

- P – a business operating in State A
- Partner Smith – a nonresident of State A
- Corp – a business operating entirely outside State A
- QIP – a qualified investment partnership with offices inside and outside State A
- QIP Partner Jones – a partner in QIP but does not participate in the activities of QIP
- State A uses a single sales factor apportionment formula

COMBINED MODEL PROVISIONS – STATE SOURCING

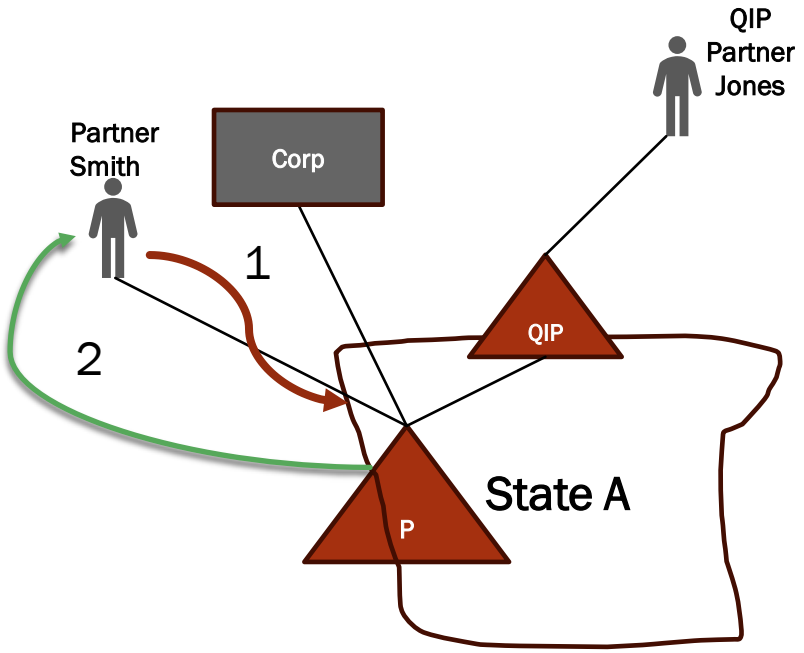
- Example 1
  - Apportionment at the entity level matches UDITPA rules
  - A nonresident partner is taxed in the source state
  - Withholding or PTE taxes are dependent on the attributes of the partner



Example 1 – Simple Non-Resident Partner:

- P's income is 100% apportionable
- P allocates $10,000 of income to Smith
- P's apportionment factor in A is 50%
- Smith receives $5,000 of partnership income sourced to State A
- Withholding tax is 10% in State A
- P retains $500 from the distributive share as withholding tax.

Information exchange



Example 1 – Simple Non-Resident Partner:

1. Downstream Information

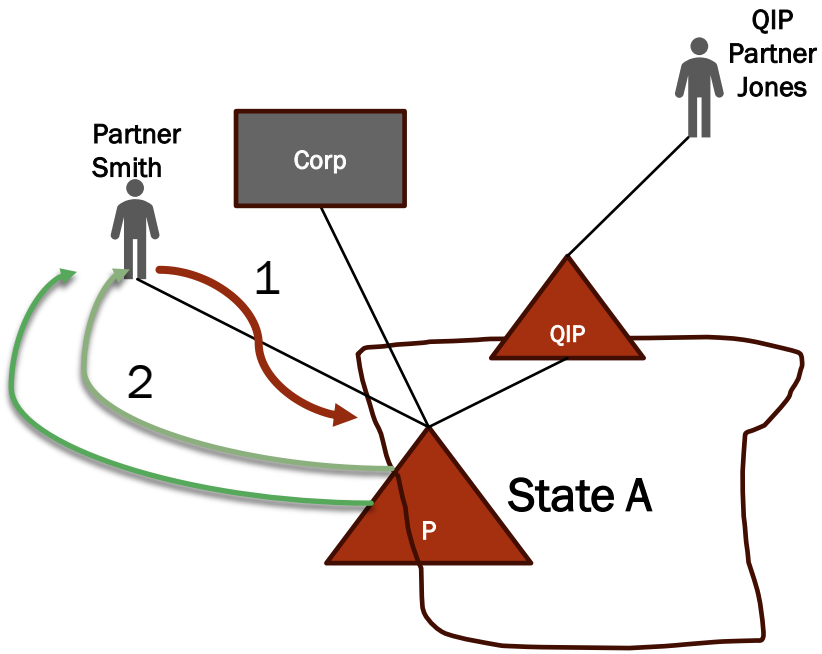
   P must know some of Smith's attributes like residency to apply State A withholding laws.

2. Upstream information

   - P must provide Smith with a State A Schedule K-1, showing Smith's distributive share of:
     - State A source income,
     - State A modifications, and
     - State A withholding information.
   - P must inform Smith of any information not included in federal or State A Schedules K-1 that is needed to file a return in his state of residence.

COMBINED MODEL PROVISIONS – STATE SOURCING

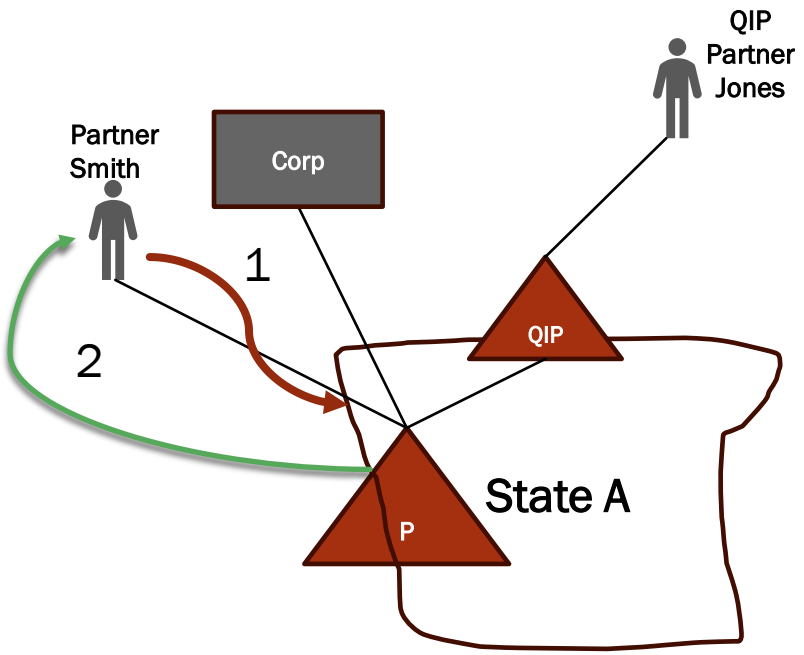
- Example 2
  - Guaranteed payments (GP)
  - Alignment with distributive shares sourcing
  - Sourcing of GP is different in the partner's state
  - A nonresident partner is taxed in the source state
  - Withholding is dependent on the attributes of the partner



Example 2 – Simple Guaranteed Payment:

- P's income is 100% apportionable
- P allocates $10,000 to Smith
- P also pays Smith a $2,000 guaranteed payment for services Smith performs outside of State A
- P 's apportionment factor is 50%
- Smith receives $6,000 of partnership income sourced to State A ($12,000 X 50%).
- Withholding tax is 10% in State A
- P retains $600 as withholding tax.
- Smith's residence state taxes GPs as wages.

Information exchange

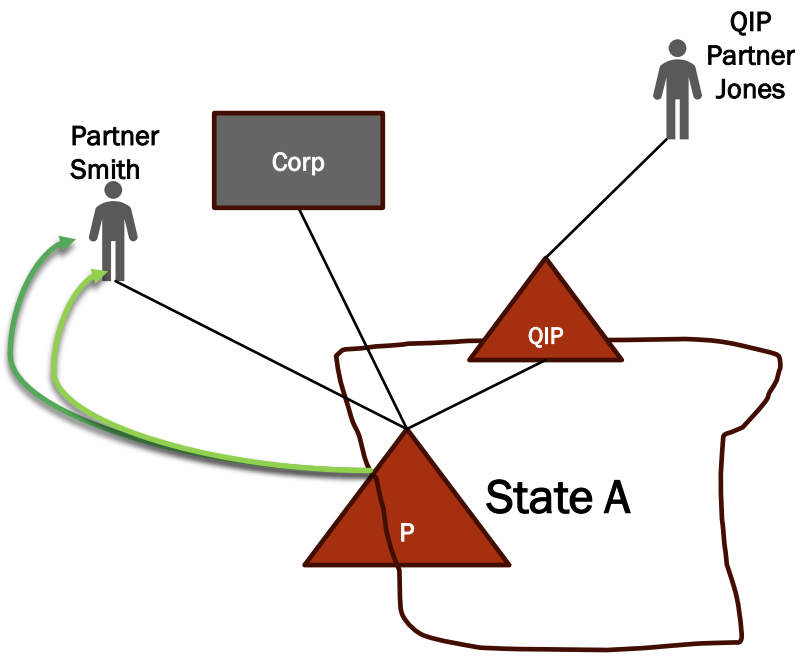


Example 2 – Simple Guaranteed Payment (GP):

1. Downstream information.
   - P must know:
     - Some of Smith's attributes like residency status.
     - GP treated differently in Smith's state of residency
2. Upstream information
   - P must provide Smith with a State A Schedule K-1, showing Smith's distributive share of:
     - State A source income information,
     - State A source GP, and
     - State A withholding information.

COMBINED MODEL PROVISIONS – STATE SOURCING

- Example 3
  - Non-apportionable character of the income determined at the partnership level
  - A nonresident partner is taxed in the source state
  - Withholding is dependent on the attribute of the partner
  - Special allocation
  - Partner's state has an exclusion for long-term capital gain from the sale of collectible cars.
  - Source state imposes a lower rate for capital gains



Example 3 – Simple Apportionable / Non-Apportionable Income:

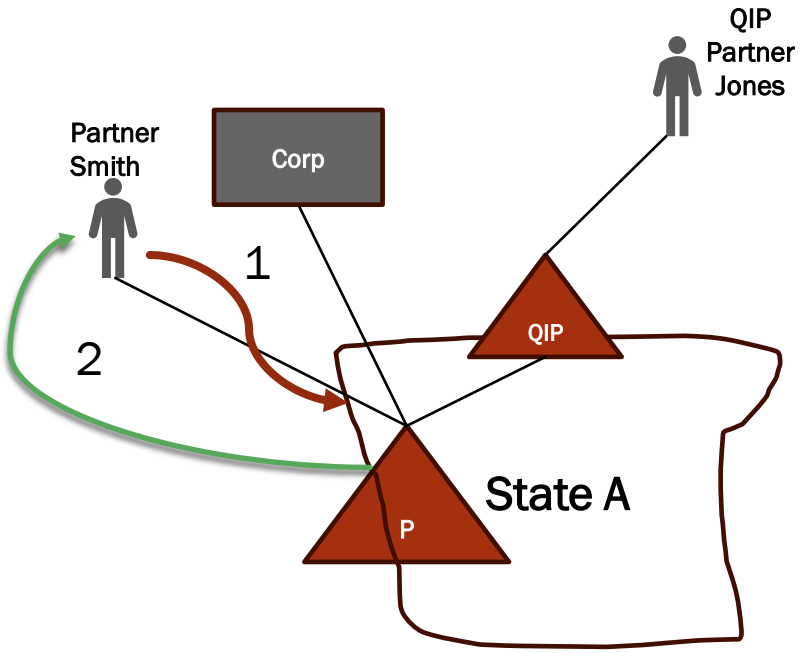
- P has:
  - $100,000 in apportionable income
  - $20,000 non-apportionable income sourced entirely to State A
- P allocates to Smith:
  - $10,000 (10%) of its apportionable income
  - $5,000 (25%) of a non-apportionable long-term capital gains
- P has $100,000 of total sales with $50,000 in State A
- Smith would have $10,000 of partnership income sourced to State A

  $10,000 X $50,000/$100,000 = $5,000 apportioned to State A

  Plus

  $5,000 allocated to State A

Information exchange



Example 3 – Simple Apportionable / Non-Apportionable Income:

1. Downstream information.
   - P must know:
     - Smith residency
     - Smith's residence state tax modifications for long-term capital gains.
2. Upstream information. P Will have to provide Smith with a State A Schedule K-1, showing Smith's distributive share of:
   - State A source income information,
   - Break down of items per character for treatment of capital gains in State A, and
   - State A withholding information,

QUESTION

- **Should P provide information regarding the nature of the asset sold (sports car) to apply the correct capital gain treatment in that state?**

  Yes. Probably already.

Uniform Partnership Act

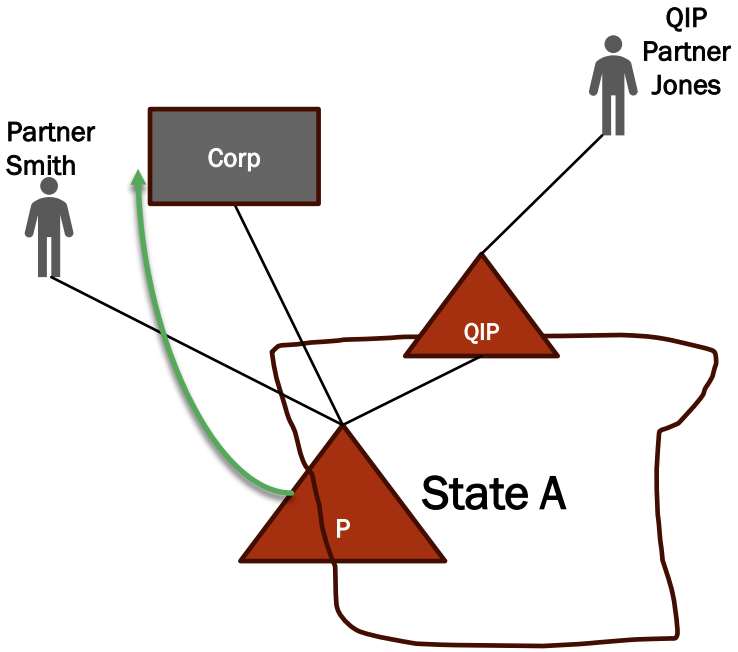
SECTION 408. RIGHTS TO INFORMATION OF PARTNERS AND PERSONS DISSOCIATED AS PARTNER. …
(c) The partnership shall furnish to each partner: (1) without demand, any information concerning the **partnership's business, financial condition, and other circumstances which the partnership knows and is material to the proper exercise of the partner's rights and duties under the partnership agreement or this [act],** except to the extent the partnership can establish that it reasonably believes the partner already knows the information; and

REMARK

Part III of the model requires the transmission of upstream information that is neither on a federal Schedule K-1 or on a source state Schedule K-1.

The more developed a source state Schedule K-1 is the more the information for residence and source state overlaps.

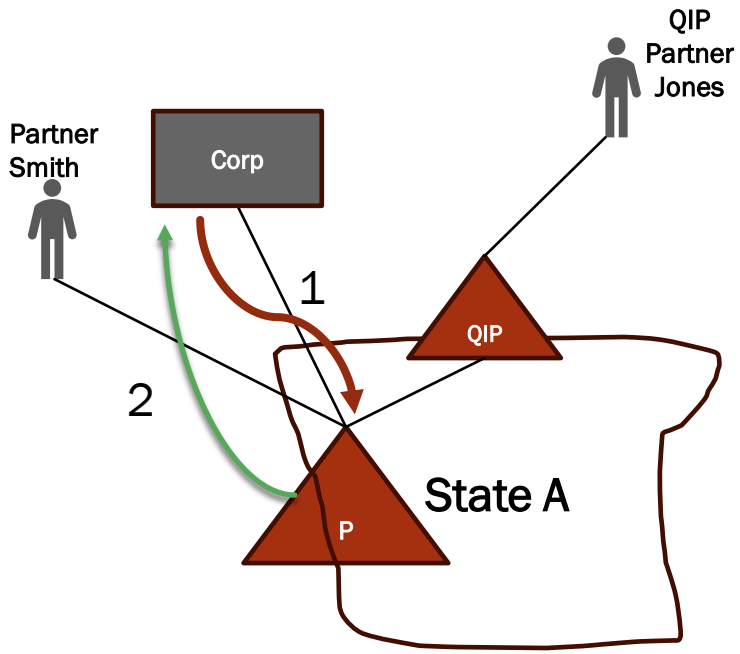
Example: Interest on US bond income exemption is typically the same in each state.



Example 4 – Simple Corporate Partner:

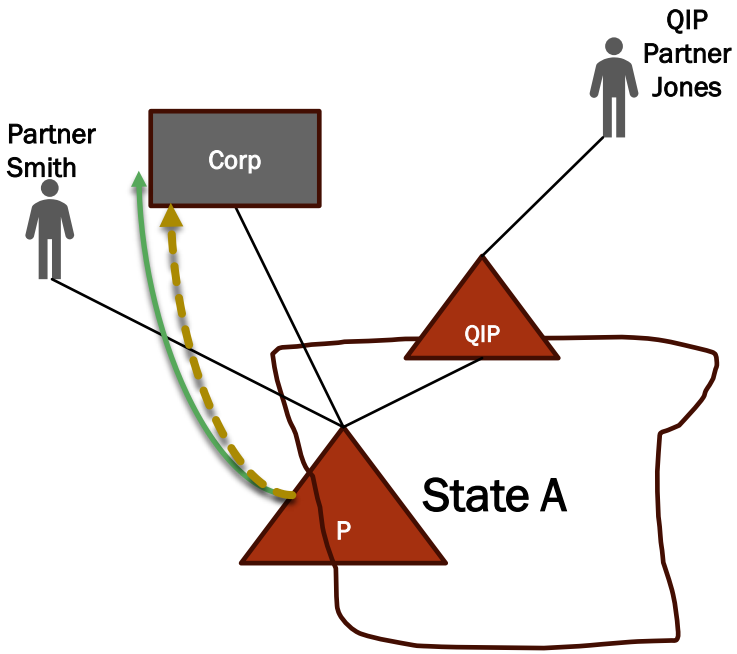
- Corp's and P's businesses are not unitary
- Same facts as Examples 1 and 3 except the allocation is to Corp
- Same results as in Examples 1 and 3
  - 100% apportionable income = $5,000
  - Apportionable and non-apportionable income (special allocations) = $10,000

Information exchange



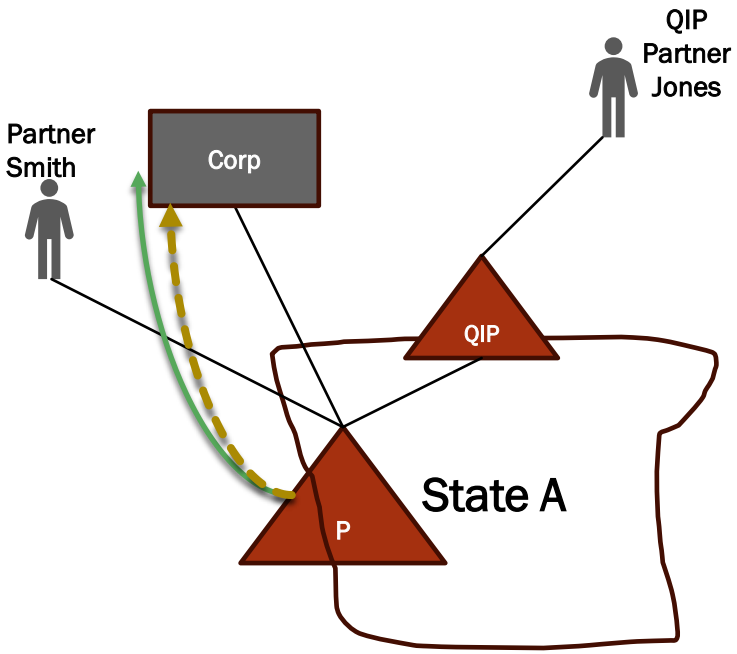
Example 4 – Simple Apportionable / Non-Apportionable Income:

1. Downstream Information.
    1. P must know:
        - Corp. entity type (C Corp; S Corp; Tax Exempt)
        - Corp status in State A. (foreign or domestic)
2. Upstream Information.
    1. P must provide Corp with a State A Schedule K-1, showing its distributive share of:
        - State A source income information,
        - Break down of items per character with State A modifications.
        - State A withholding information.



Example 5 – Corp's & P's Businesses are Unitary:

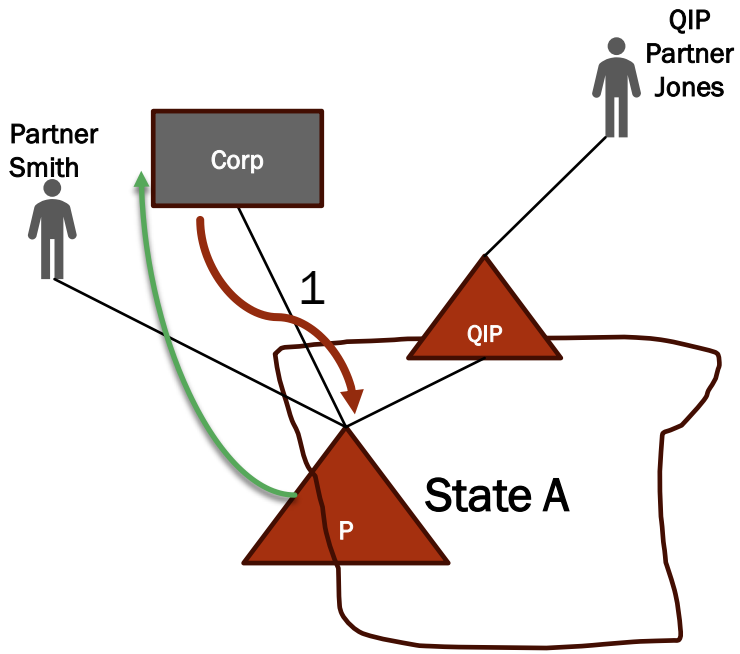
- Corp's own business is unitary with P's business and State A uses blending
- Same facts as Example 1 except the allocation is to Corp
- For blending at the partner level, we not only need to know the amount of partnership apportionable income allocated to Corp but also *Corp's share* of apportionment items.



Example 5 – Corp and P's Businesses are Unitary (cont'd):

- P allocates $10,000 of its net partnership income to Corp – which is 60% of P's income ($16,666)
- Again, P has $100,000 of total sales with $50,000 in State A
- Corp has $100,000 of income with $400,000 of total sales and $0 sales in State A
- Corp's blended apportionable income = $110,000
- Corp's blended factor –
  - Total sales = $400,000 (Corp's) + 60% of $100,000 (P's) = $460,000
  - State A sales = $0 (Corp's) + 60% of $50,000 = $30,000
  - Sales factor = $30,000/$460,000 = 6.521%
- Corp's State A source income = 6.521% X $110,000 = $7,173

Information exchange

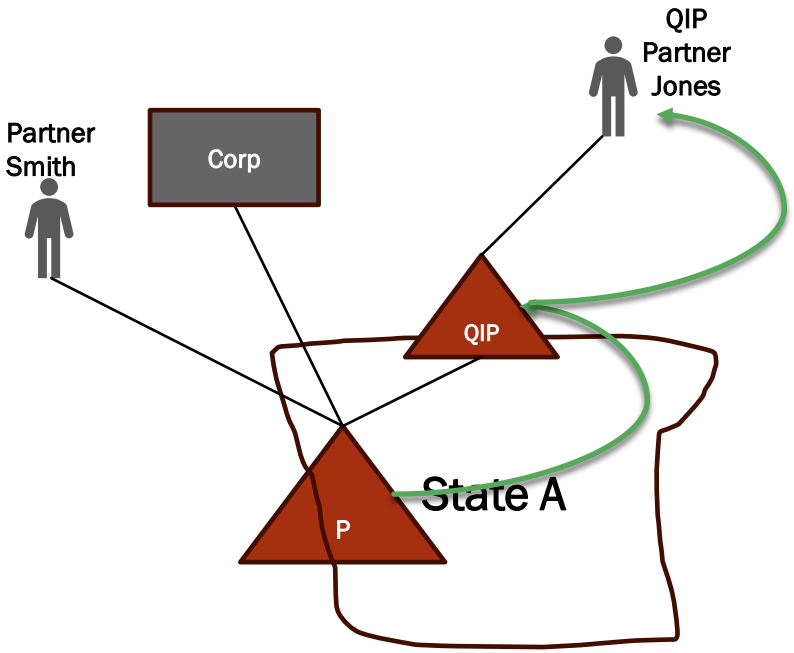


Example 5 – Corp's & P's Businesses are Unitary:

1. Downstream Information. P must know:
   - Corp. entity type (C Corp; S Corp; Tax Exempt)
   - Corp status in State A. (foreign or domestic)
2. Upstream information: P Will have to provide Corp with a State A Schedule K-1, showing:
   - State A source income information,
   - Break down of items per character with State A modifications.
   - Withholding information if any.
   - Apportionment items

REMARKS

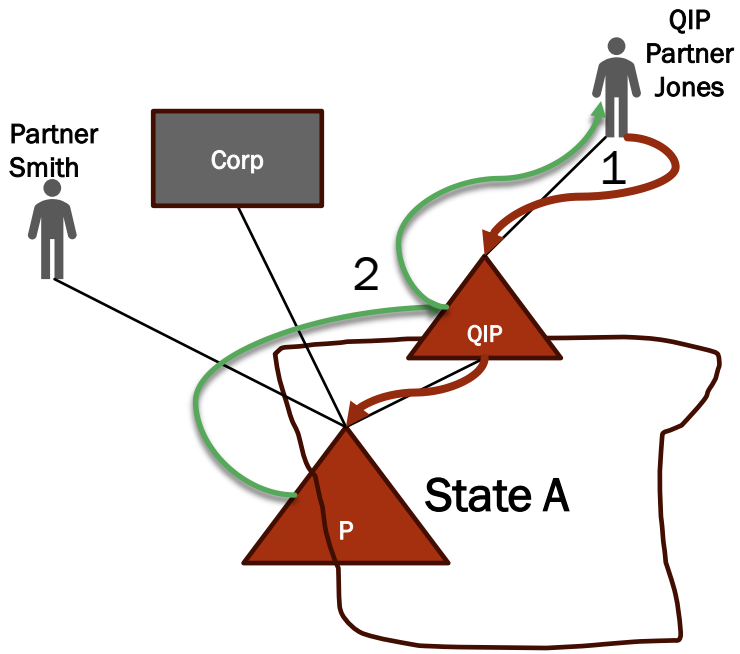
- The model does not require a partnership to blend its income with its partners' other items of income to determine the sourcing of the partnership income. Blending may occur on the partner's return. A partnership does not need its partner's income and sourcing information to complete the information return.
- It is a good idea to include apportionment items (by default) on the state schedule K-1 because source income at the partnership level is determined without regard to whether the partner is unitary. However, the partner may be unitary with the partnership and may have to blend its distributive share of partnership income with its on income and factors.
- Intercompany transactions should also be identified on source state Schedules K-1, to be removed when blending at the partner's level.



Example 7 – QIP Partner Jones:

- P allocates $10,000 of its net partnership income to QIP
- QIP allocates $5,000 of P's net partnership income to QIP Partner Jones
- P has $100,000 of total sales with $50,000 in State A
- Using P's apportionment factor, Jones would have $2,500 of partnership income sourced to State A

Information exchange



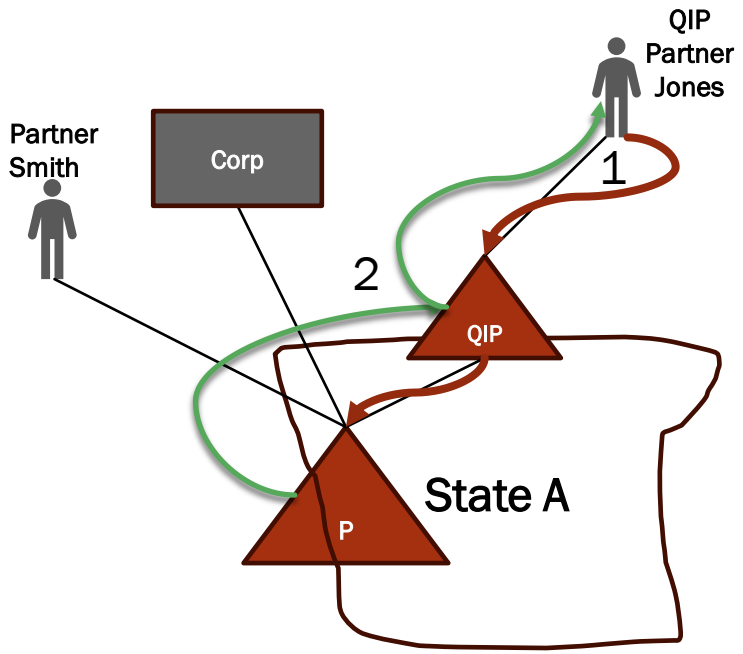
Example 7 – QIP Partner Jones:

1. Downstream Information.
   - QIP must know Jones attributes to apply QIP sourcing rules.
   - P must know QIP entity type and status in State A.
   - P must know Jones attributes (residency) to provide information regarding Jones' residence state modifications.

Remark: In a tiered structure, each tier is responsible for the downstream transmission of information allowing direct and indirect partners to meet their tax obligations.

Looks through rules for federal tax purposes use the same principle. See look through rules for IRC 1446 in Treas. Reg. 1.1446-5.

Information exchange



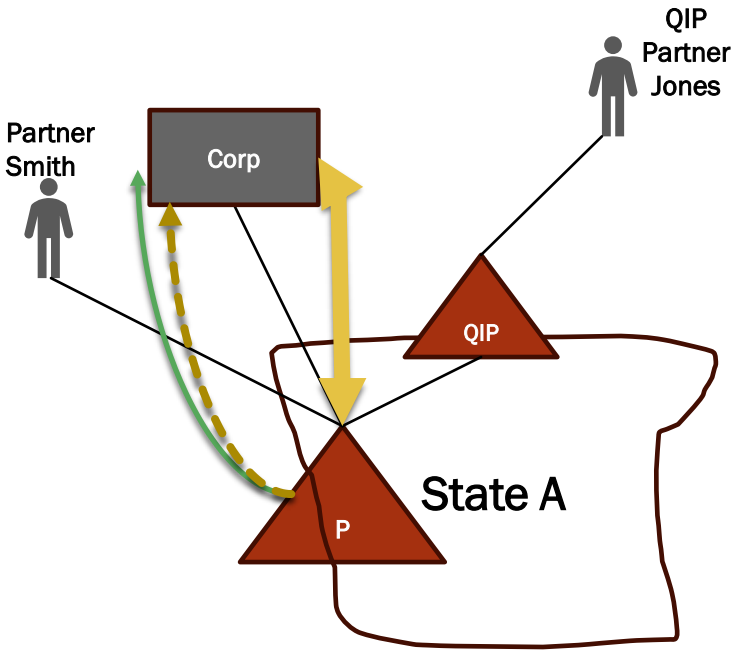
Example 7 – QIP Partner Jones:

2. Upstream information
   - P must provide QIP with a State A Schedule K-1 showing:
     - State A source income information,
     - break down of items per character with State A modifications,
     - Withholding information, and
     - Apportionment items (default).
   - QIP must provide Jones with a State A Schedule K-1 showing Jones' distributive share of:
     - State A source income from P with items broken down per character of income, and
     - State A withholding, and
     - State A modifications.

REMARKS

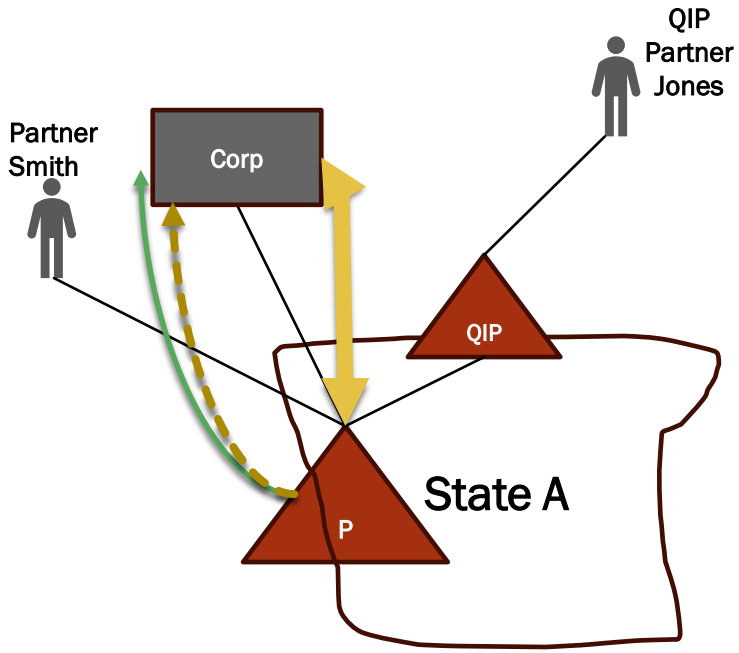
- Note that when separate apportionment occurs or the absolute value method must be used, the upstream information flowing to an upper-tier partnership must be detailed and must include:
  - Each separately apportioned income with corresponding apportionment items.
  - When a special allocation occurs and the absolute value method is used, the upstream information does not need to include the factor baseline, the allocated apportionment items are sufficient.

End of the information transmission presentation.



Example 6 – Corp's and P's Businesses are Unitary – with Intercompany Transactions:

- Same facts as Example 5 except Corp has charged P a fee of $20,000 during the year. (Assume that fee is included in Corp's separate sales amount—sourced outside State A.)
- Corp's blended apportionable income =
  - Total Corp income of $100,000
  - Plus its P income of $10,000
  - Equals $110,000



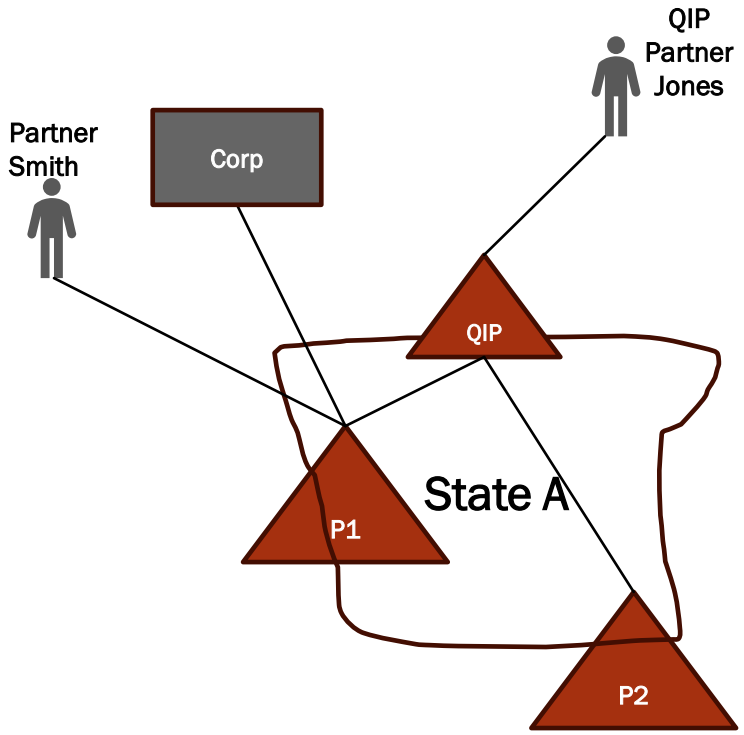
Example 6 – Corp's and P's Businesses are Unitary – with Intercompany Transactions (cont'd):

- Corp's blended factors –
  - Total sales = $400,000 (Corp's) – 60% of $20,000 = $388,000 + 60% of $100,000 (P's) = $448,000
  - State A sales = $0 (Corp's) + 60% of $50,000 = $30,000
  - Sales factor = $30,000/$448,000 = 6.7%

Corp's State A source income = 6.7% X $110,000 = $7,370

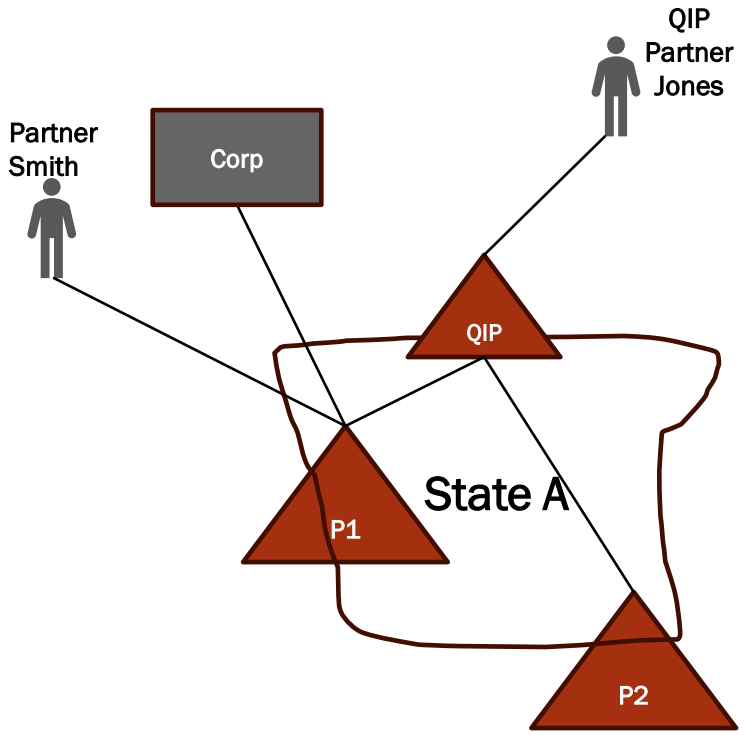
NOTE – BLENDING

- Include apportionable partnership income in the partner's own apportionable base –
  - *Eliminating the effect of intercompany transactions* (that is the same share of the partner's own income or expense as reflected in its partnership income)
- Include a share of the partnership's receipts or sales –
  - *Eliminating from that combined factor the effect of intercompany transactions* (again, the same share as reflected by the partner's partnership income).
- Blending or not and how you do it makes a difference –
  - Separate (partnership level) apportionment = $5,000
  - Blending (no intercompany transactions or no elimination) = $7,173
  - Blending (intercompany transactions with elimination) = $7,370



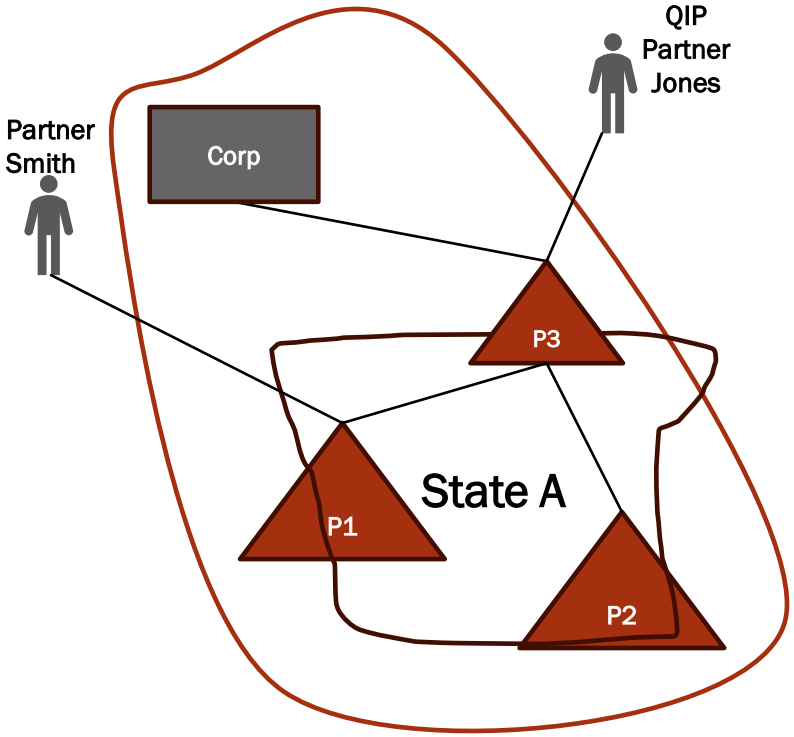
Example 8 – QIP – Separate Apportionment:

- QIP acquires an 80% interest in P2. P becomes P1.
- QIP is not unitary with P2 (otherwise it would not be a QIP)
- Same facts as example 7 between P1, QIP and Jones.
- P2 has a net loss of ($25,000) and allocates 80% ($20,000) of it to QIP.
- QIP allocates ($10,000) of its share of P2's net partnership income to Jones
- P2 has $2,000,000 of total sales with $150,000 in State A
- P2 apportionment factor in State A is 7.5%
- Jones would have $1,750 of income sourced to State A including:
  - $2,500 from partnership P1, and
  - ($750) from partnership P2. [($10,000) x 7.5%]



Example 8 – QIP – Separate Apportionment:

- QIP does not blend the two streams of source income from P1 and P2
- Each distributive share is apportioned separately based on the apportionment occurring at P1 and P2 levels
- Jones' State A source income is the sum of his shares of the QIP shares of P1 and P2 partnership income separately apportioned by P1 and P2.



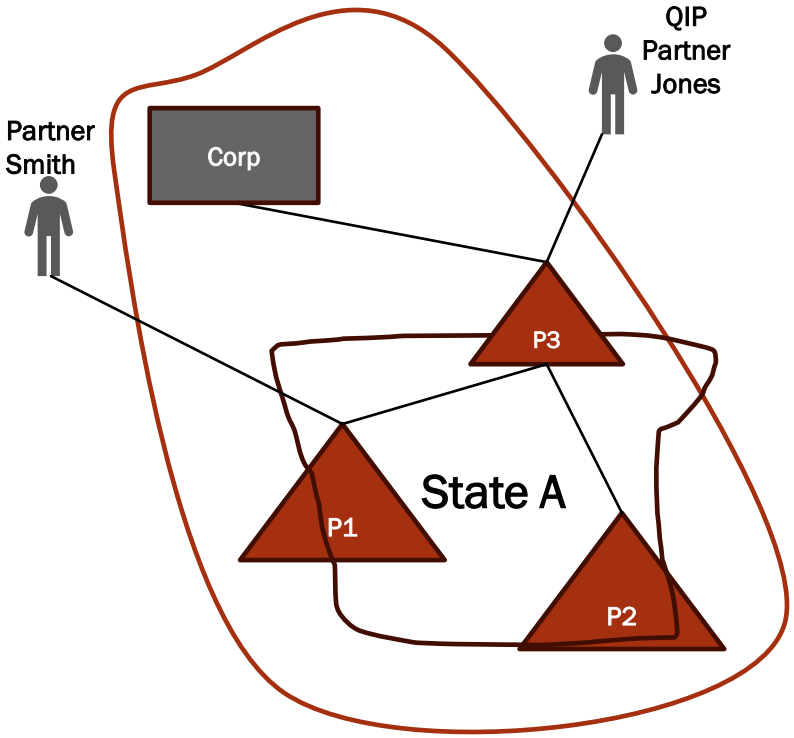
Example 9 – Unitary group – Blending:

- Corp becomes a partner in QIP. QIP loses its investment partnership status and is now called P3
- Corp, P1, P2 and P3 are all engaged in the same unitary business.
- As a reminder, P3 distributive shares are:
  - 60% of P1's net income and
  - 80% of P2's net income
- P3 blends its distributive shares of P1 and P2 income because they are all engaged in the same unitary business
- P3's blended apportionable income is ($10,000) which is the sum of $10,000 from P1 and ($20,000) loss from P2

REMARKS

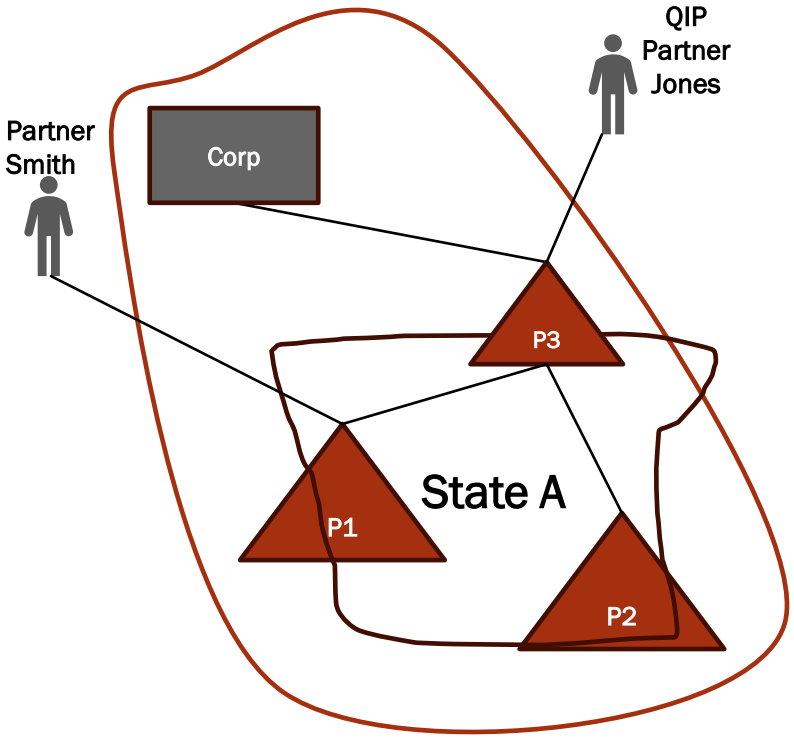
This is taxation of income in source states.

The attributes of the partner do not affect the sourcing of apportionable income. They do affect subjection to entity level taxes.



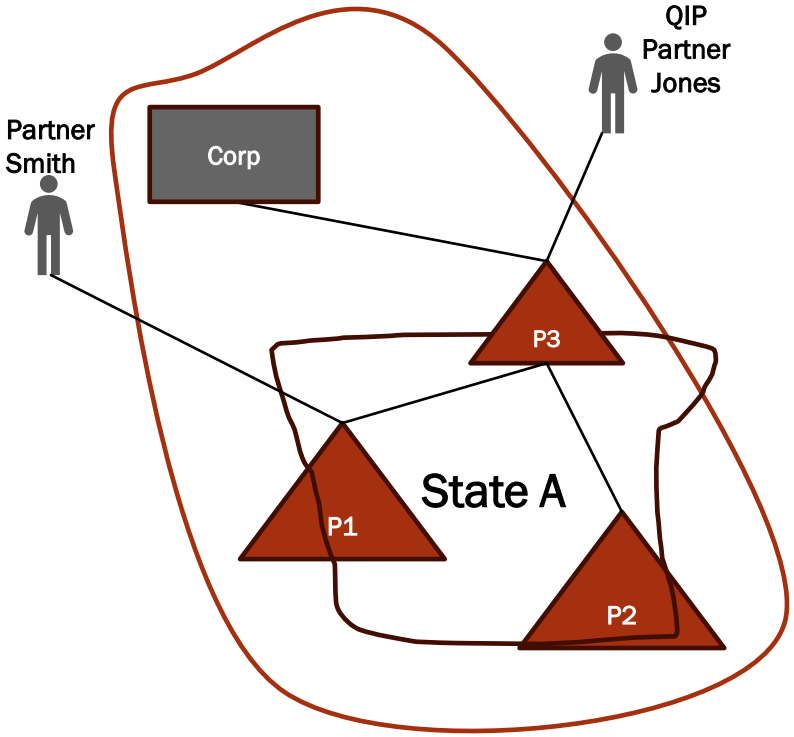
Example 9 – Unitary group – Blending:

- P3's apportionment factor is : 9.0361% calculated as follows:
- Total sales: $1,660,000, which is the sum of
  - $60,000 (60% of P1 sales of $100,000), plus
  - $1,600,000 (80% of P2 sales of $2,000,000)
  - State A sales: $150,000, which is the sum of
    - $30,000 (60% of P1 State A sales of $50,000), plus
    - $120,000 (80% of P2 State A sales $150,000)
- P3 State A source loss is ($904), which is 9.0361% of ($10,000)
- P3 allocates 40% of that loss to Jones and 60% to Corp
- Jones has ($362) of State A loss



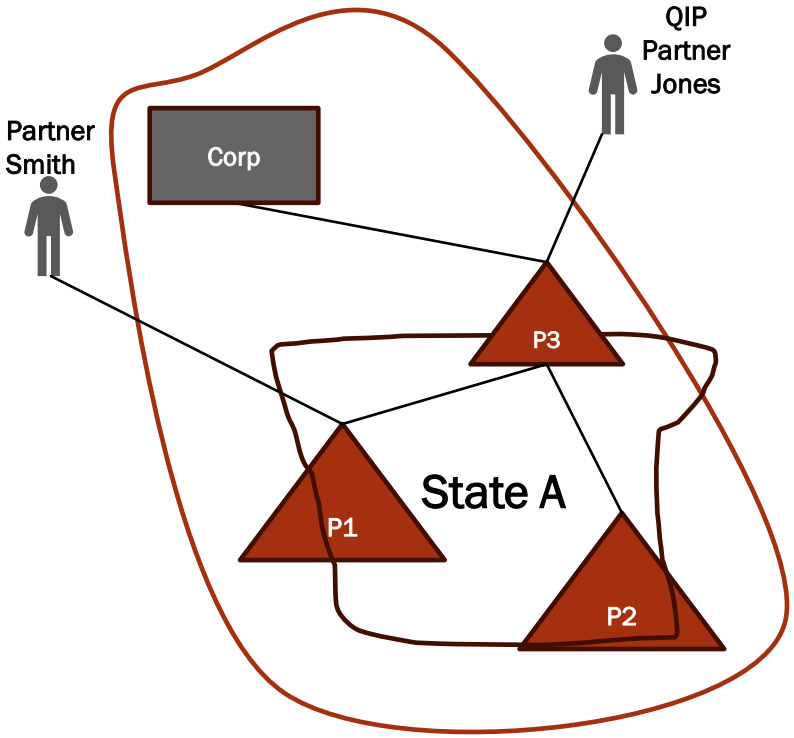
Example 9 – Unitary group – Blending:

- Corp's blended apportionable income for its unitary business is $94,000: $100,000 + ($6,000) from P3
- Corp's blended apportionment factor is 6.447% which includes 100% of its own factors and 60% of P3 factors, calculated as follows:
  - Total sales: $1,396,000, which is the sum of
    - $400,000 of Corp total sales, plus
    - $996,000 (60% of P3 total blended sales of $1,660,000)
  - State A sales: $90,000 (60% of P3 State A blended sales of $150,000)
- Corp has State A income of $6,060, which is 6.447% of $94,000



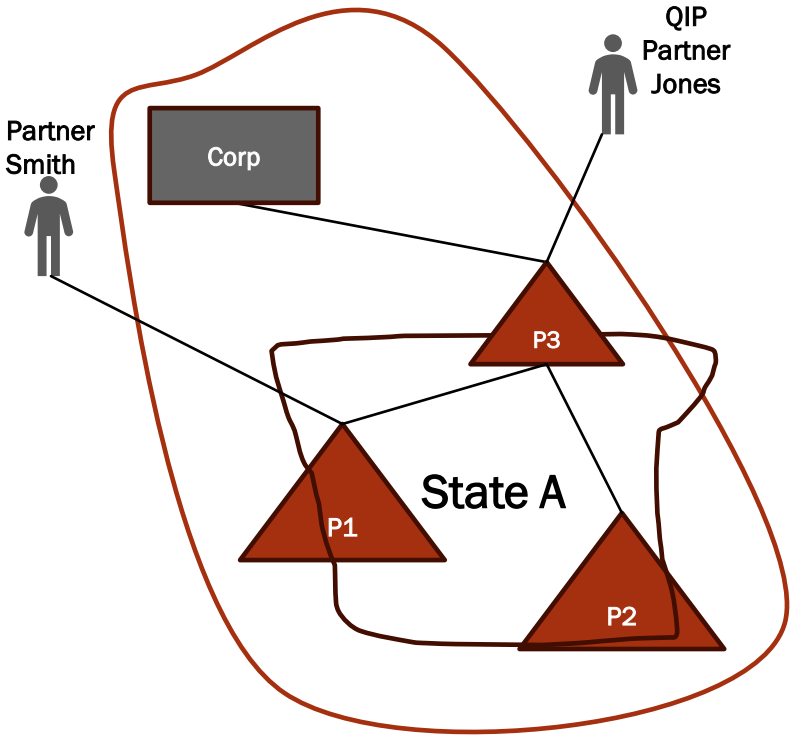
Example 9 – Unitary group – Blending:

- In Example 9 we see that the members of the unitary group blend their distributive shares as they are allocated up the ownership structure.
- Jones recognizes a State A loss of ($632) derived from the blending of distributive shares at P3 level.
- Corp recognizes a State A gain of $6,060 derived from the blending of P3 distributive shares with its own gain.
- Blending occurring at different level generates different results, as tiers add more gain or losses to the blended apportionable income.
- Notice that Smith is receiving a distributive share sourced using apportionment that is not blended. Both separate apportionment and blending co-exist necessarily within a partnership structure.



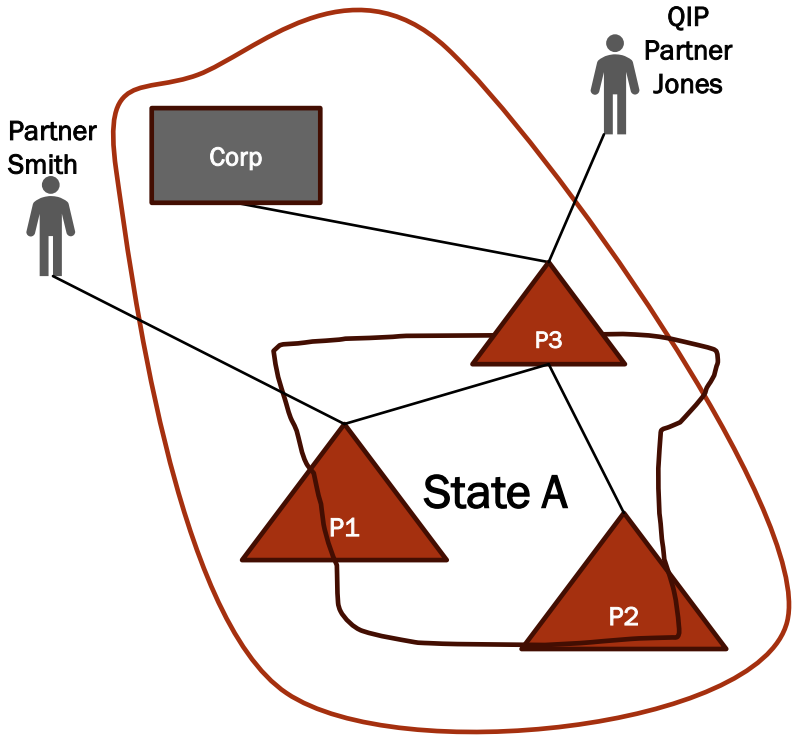
Example 10 – Unitary group – Blending – Special Allocations:

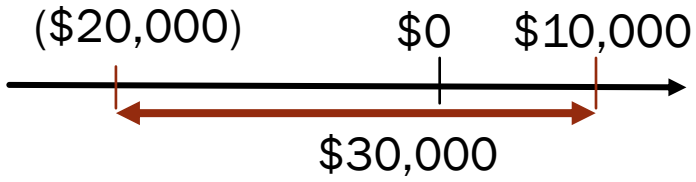
- Same as example 9, except that P3 allocates ($20,000) of losses to Corp and $10,000 of income to Jones.
- P3 blends P1 and P2 income and factors because they are all engaged in the same unitary business.
- P3 blended apportionable income is still ($10,000) and its factor is still 9.0361%
- P3 State A source income is still ($904)
- Yet Jones' State A income is now $904 which is 9.0361% (P3's State A factor) times $10,000
- Corp's blended apportionable income for its unitary business is $80,000: $100,000 + ($20,000)
- Corp receives more loss than P3 net partnership loss, while Jones receives gain. Corp will use the absolute value method to calculate its share of P3 apportionment items.



Example 10 – Unitary group – Blending – Special Allocations:

- The absolute value method compares losses and income equally based on their absolute value to distribute the sales between partners.
- P3 factor baseline is the sum of gains and losses allocated $30,000 = $10,000 + $20,000.
- Corp's share of factor baseline is $20,000
- Corp share of P3 sales is 66.66% which is $20,000/$30,000 using absolute value
- Corp's includes $1,106,556 of P3's total sales which is 66.66% times $1,660,000.
- Corp's total sales is $1,506,556 which is the sum of Corp's share of P3's total sales and its own sales of $400,000.
- Corp's includes $99,990 of P3's State A sales which is 66.66% of $150,000.
- Corp's apportionment factor is 6.637% which is $99,990 / $1,506,556
- Corp's State A income is $5,309 which is 6.637% of $80,000





Example 10 – Unitary group – Blending – Special Allocations:

- Special allocations can pose a paradox for the assignment of apportionment items when distributive shares of opposite signs are allocated to different partners. That is P3 in our example.
- If the total partnership distributive share and the partner's own distributive share are both positive (income) or negative (loss), then the partner's share of factors is simply the proportion of that partner's distributive share to the total partnership distributive share. See example 9.
- Special allocations can result in a partner receiving positive distributive share while the total partnership distributive share is negative, or vice versa, where the partner receives a negative distributive share while the total partnership distributive share is positive. This means the share determined by dividing the partner's distributive share by the total distributive share will be a negative percentage. The absolute value method avoids this problem by converting all amounts to absolute values so that the share reflects the amplitude of the distribution.
- The absolute value method measures that amplitude and distributes apportionment items proportionally based on each partner's share of that amplitude called "factor baseline". Jones receiving 1/3 and Corp receiving 2/3 of the of the apportionment items.