**Proposed Draft – Treatment of Investment Partnership Income (Clean)
For Discussion Purposes Only
August 18, 2022**

**Title. Treatment of Certain Income of Nonresident Qualifying Investment Partnership Partners. Section 1.** Purpose: [Drafter’s note: This section is included to give guidance to the use of anti-abuse authority in Section 4 below.]

The purpose of this [Act/Section/Rule] is to provide a safe harbor for the sourcing of investment income or loss by certain nonresident partners where that income or loss would have been sourced to the nonresident partner’s state of residency had the partner directly engaged in the activities of the entity that generated the income or loss. In cases where the requirements of this [Act/Section/Rule] are met, [the State] agrees that the income or loss is properly sourced to the nonresident partner’s state of residence under [reference to general state tax and sourcing statutes].

**Section 2. Definitions:**

(a) In this [Act]:

(1) “Amount of Gross Income or Proceeds” refers to the total of all items of gross income or proceeds from activities or sales of any kind.

(2) “Dealer in Qualifying Investments” is any person who meets the definition of a "dealer” in 26 U.S.C. § 475(c) with respect to Qualifying Investments or who regularly purchases Qualifying Investments for sale to customers in the ordinary course of a trade or business or regularly offers to enter into, assume, offset, assign or otherwise terminate positions in Qualifying Investments with customers in the ordinary course of a trade or business;

(3) “QIP Manager” means any partner that holds an ownership interest in a Qualified Investment Partnership that was acquired in exchange for performing the management of the Partnership including recruiting investors, overseeing investments, performing administrative functions, and similar activities.

(4) “Nonresident QIP Partner” means a person subject to tax under [reference to state income tax law] that holds an ownership interest in a Qualified Investment Partnership and is neither a Dealer in Qualifying Investments nor a QIP Manager at any time during the tax period, provided the person is:

(A) an individual who is a nonresident as determined under [reference to applicable state law];

(B) an estate that is a nonresident as determined under [reference to applicable state law]; or

(C) a trust that is a nonresident as determined under [reference to applicable state law].

[Drafter’s Note: States should confirm that the general treatment of taxable estates and trusts and the sourcing of their income would be compatible with the purpose of this safe harbor.]

(5) “Partnership,” as the term is used, alone or in conjunction with other terms, means an entity properly subject to treatment as a partnership under Subchapter K of the Internal Revenue Code.

(6) “Other Pass-Through Entity” means an entity, other than a Partnership, whose income is taxed to its interest holders and includes corporations properly taxed under Subchapter S of the Internal Revenue Code and certain taxable trusts.

(7) “Qualified Investment Partnership” means a Partnership that meets all the following requirements for the applicable tax period:

(A) No less than 90 percent of the cost of the Partnership’s total assets consists of Qualified Investments and the office facilities and tangible personal property reasonably necessary to carry on its investment activities;

(B) No less than 90 percent of the Partnership’s Amount of Gross Income or Proceeds recognized in the tax year are items that give rise to Qualified Investment Partnership Income (Loss). For purposes of this test, only gross income or proceeds recognized by the Partnership are included in the calculation of the percentage;

(C) The Partnership is not a Dealer in Qualifying Investments at any time during the tax period; and

(D) The Partnership is not a financial institution as defined in [reference to applicable state law].

(8) “Qualified Investment Partnership Income (Loss) means items of income, expense, gain, or loss that are derived from Qualified Investments, including interest, dividends, or gains or losses from exchange of those Qualified Investments. Whether the items meet the requirements of this definition is determined when those items are first recognized by a Partnership or Other Pass-Through Entity regardless of whether those items then flow through other Partnerships or Other Pass-Through Entities.

(9) “Qualified Investments” means:

(A) Common stock of corporations, including preferred or debt securities convertible into common stock; and preferred stock, including debt securities convertible into preferred stock, provided that the corporation is taxed under the Internal Revenue Code Subchapter C;

(B) Bonds, debentures, and other debt securities such as certificates of deposit and collateralized securities;

(C) Deposits and any other obligations of banks and other financial institutions regulated by the United States government, a state, or by any political subdivision or governmental agency thereof, and cash and cash equivalents, including foreign currencies;

(D) Corporate stock and bond index securities, future contracts, derivative securities, warrants or options on securities, and other similar financial securities and instruments;

(E) Interest in a Partnership or Other Pass-Through Entity but only if that Partnership or Other Pass-Through Entity would meet the requirements to be a Qualified Investment Partnership under Section 2(a)(3) above;

(F) Other similar or related financial or investments contracts, instruments, or securities.

The term does not include:

(G) Any investment in a captive REIT, as defined by [reference to federal or state law]; or

(H) Loans that are not debt securities.

(b) All other terms used in this Section are given their general meaning as used under the [reference to personal income tax act].

**Section 3. Certain Qualified Investment Partnership Income of Nonresident QIP Partners Excluded from Personal Income Tax.**

A Nonresident QIP Partner may exclude from tax under [reference to state income tax] the partner’s distributive share of Qualified Investment Partnership Income (Loss).

**Section 4. Authority Delegated to the [State Revenue Agency].**

(a) The [state revenue agency] has authority to issue regulations and other guidance to carry out the purpose of this [Act] including, [but not limited to]:

(1) Requirements for the certification of Qualified Investment Partnerships;

(2) Requirements for information returns to be filed by Qualified Investment Partnerships including requirements to provide lists of partner names and addresses, lists of investments or other investment information, lists of other assets and their values, and similar records.

(3) Rules for the calculation of asset and income values for purposes of implementing the requirements of this [Act];

(4) Filing of withholding or estimated payments [and/or composite returns] by Qualified Investment Partnerships when any income of such Partnerships is subject to tax in this state and as provided by this Section and [reference to state law] waiver of requirements and related penalties in cases where a previously qualifying Partnership fails to qualify.

(b) A Partnership must state on its tax return whether it asserts that it meets the requirements to be treated as a Qualified Investment Partnership for the tax period. It must also provide information to its partners sufficient so that they can determine the proper amount of any Partnership items of income, expense, gain, or loss that are not Qualified Partnership Investment Income (Loss), as well as any other information determined by the [state revenue agency] to allow proper reporting of income or loss that would be taxable in the state.

(c) Upon a properly completed and timely filed application, as directed by the [state revenue agency], the [state revenue agency] may certify that a Partnership meets the requirements to be treated as a “Qualified Investment Partnership” for a particular tax period. In granting this certification, the [state revenue agency] has discretion to waive one or more of the requirements for a particular tax period for a Partnership that might fail to meet the qualification, provided that the Partnership demonstrates that this failure would not alter the treatment of the Qualified Investment Partnership Income (Loss) by Nonresident QIP Partners under [reference to applicable state income tax provisions], and such qualifying income (loss) can be properly determined.