



State Taxation of Partnerships – Report to the Uniformity Committee

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PROCESS:

1. Identify and generally describe a comprehensive list of potential issues.
2. Note the important relationships between those issues.
3. Select a particular issue and develop generally recommended practices or positions.
4. Repeat step 3 until all major issues have been addressed and reconcile any differences.
5. Agree on overall set of recommended practices or positions for all issues.
6. Begin creating draft models, etc., to carry out the recommended practices or positions.

Comprehensive Issue Outline – Ongoing

- Nexus and Jurisdiction
- Tax Base
- Sourcing
- Gain on Sale of Interest
- Administrative and Enforcement

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Investment Partnerships

- White Paper
 - Draft Model
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Guaranteed Payments

- Draft White Paper
- Differences in State Treatment
- Discussion of a Possible Model

INVESTMENT PARTNERSHIPS – MODEL REG – SEC. 1

Under the [reference to state’s individual income tax], a nonresident partner’s distributive share of partnership income is generally allocated and apportioned to this state at the partnership level based on the partnership’s business or other activities in this state. See [insert reference to applicable statutes and regulations, including UDITPA if applicable, and to IRC § 702].



INVESTMENT PARTNERSHIPS – MODEL REG – SEC. 1

But the investment related activities of a qualified investment partnership in this state do not affect how certain nonresident partners source their distributive share of that partnership's investment income.

INVESTMENT PARTNERSHIPS – MODEL REG – SEC. 1

Rather, the sourcing rules for nonresidents apply to the items of income making up the partner's distributive share from the qualified investment partnership as though the partner earned (or incurred) the items directly. See [reference to applicable statutes and regulations governing sourcing of income for nonresidents].



PREVIOUSLY - GUARANTEED PAYMENTS

- Discussed the nature of guaranteed payments
- Noted the basic federal tax treatment
- Discussed the state tax treatment
- Unclear if work group believed a model was needed

SUMMARY – GUARANTEED PAYMENTS - SCOPE

- Currently only looking at the treatment of guaranteed payments for services to direct, individual partners.
- About half the states have explicit rules.

SUMMARY – GUARANTEED PAYMENTS - ESSENTIALS

- Subchapter K –
 - Treats guaranteed payments differently from either distributive share or payments to partners not as partners (IRC 707(a)) for various purposes.
 - Treats guaranteed payments for services differently than guaranteed payments for capital.
- Under federal rules, guaranteed payments for services performed in a foreign jurisdiction are sourced as earned income to that location, and therefore are excluded from domestic net income, with certain limits.

TWO SOURCING OPTIONS

“Compensation”

- Same as wages, which are generally sourced to where the services are performed by the individual partner.
- Used by a minority of states.

“Distributive Share”

- Same as other partnership income – which is generally allocated and apportioned at the partnership or business level.
- Used by the majority of states.



PROBLEM – WHAT IS THE “RIGHT” METHOD?

- Compensation method.

OR

- Distributive share method.

COMPENSATION APPROACH – PROS AND CONS

Pros

- Similar to federal treatment.

Cons

- Have to distinguish guaranteed payments from special allocations of distributive share.
- Have to distinguish guaranteed payments for services from guaranteed payments for capital.
- Need guardrails, otherwise there may be income shifting.
- May not be consistent with PTE tax treatment.

DISTRIBUTIVE SHARE APPROACH– PROS AND CONS

Pros

- Do not have to distinguish guaranteed payments from special allocations of distributive share.
- Do not have to distinguish guaranteed payments for services from guaranteed payments for capital.
- Don't need guardrails.
- May be more consistent with PTE tax treatment.

Cons

- Different from federal approach.



PROBLEM – POTENTIAL MULTIPLE TAXATION

- Could be solved with a uniform rule.
- Could also be solved with a generous credit given by state of residency for taxes paid on certain guaranteed payments to other states on a different sourcing basis.

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Should the work group develop a model rule for sourcing guaranteed payments?

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If the work group was to draft a model rule for sourcing guaranteed payments, which method should it use?

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QUESTIONS - COMMENTS

