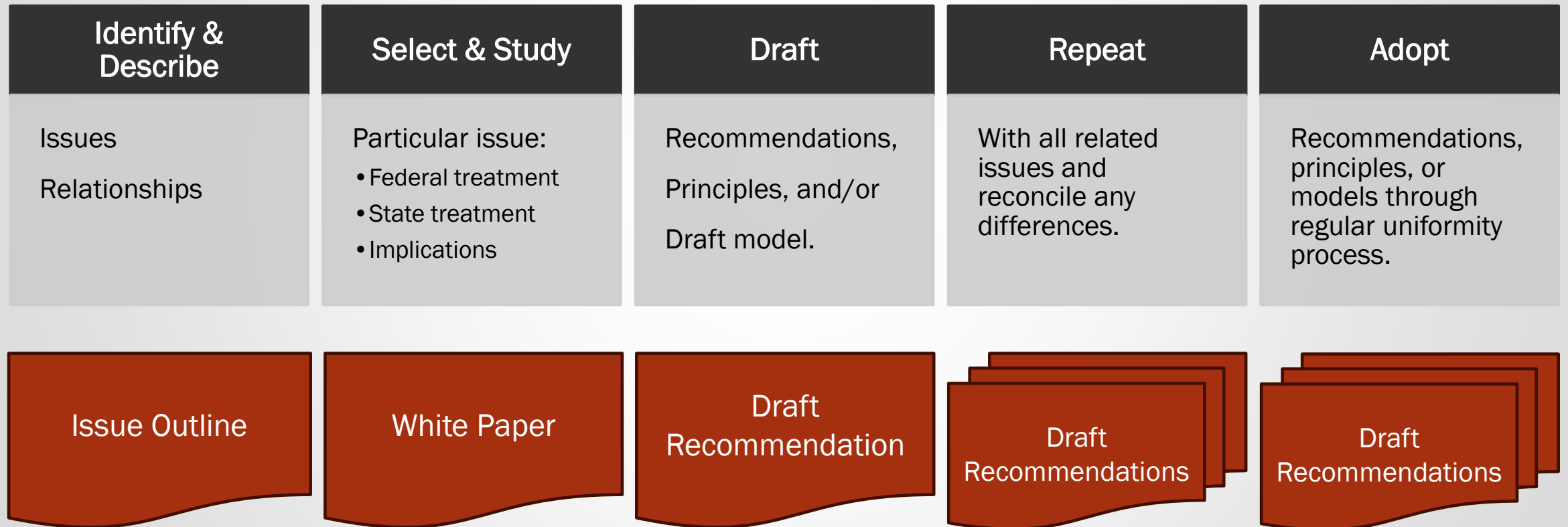




State Taxation of Partnerships – Report to the Work Group

SEPTEMBER 20, 2023

PROCESS (SLIGHTLY REVISED)



ISSUES

- Taxation of Partnership Income and Items
 - Jurisdiction and nexus – partnerships and partners.
 - Tax base – conformity and state adjustments
 - Sourcing
 - Credits for taxes paid to other states
- Taxation of Gain (Loss) from Sale of Partnership Interest
- Administrative and Enforcement
 - Information reporting
 - Withholding
 - Composite returns and entity-level taxes

WHERE ARE WE?

Sourcing guaranteed payments for services –

- Finished draft white paper and proposed recommendations.
- Need to decide whether to draft a model – **this meeting**.

Sourcing investment partnership income –

- Issued white paper and versions of a model & received comments from public and states.
- Re-issued model in the form of a regulation,
- Incorporating other feedback for additional review – **next meeting**.

Future work –

- General sourcing in complex structures.
- Possible general statement of principles.

SOURCING OF GUARANTEED PAYMENTS FOR SERVICES

- Two methods
 - **As distributive share** – using partnership factors and information to source the payments at entity level.
 - **As compensation** – based on location where partner performs the services.

SCOPE

- Guaranteed payments –
 - For services
 - Made to direct, individual partners

Schedule K-1 (Form 1065)

Department of the Treasury
Internal Revenue Service

2022

For calendar year 2022, or tax year

beginning / / 2022 ending / /

Partner's Share of Income, Deductions, Credits, etc.

See separate instructions.

Part I Information About the Partnership													
A	Partnership's employer identification number												
B	Partnership's name, address, city, state, and ZIP code												
C	IRS center where partnership filed return:												
D	<input type="checkbox"/> Check if this is a publicly traded partnership (PTP)												
Part II Information About the Partner													
E	Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)												
F	Name, address, city, state, and ZIP code for partner entered in E. See instructions.												
G	<input type="checkbox"/> General partner or LLC member-manager <input type="checkbox"/> Limited partner or other LLC member												
H1	<input type="checkbox"/> Domestic partner <input type="checkbox"/> Foreign partner												
H2	<input type="checkbox"/> If the partner is a disregarded entity (DE), enter the partner's: TIN _____ Name _____												
I1	What type of entity is this partner? _____												
I2	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here <input type="checkbox"/>												
J	Partner's share of profit, loss, and capital (see instructions):												
	<table border="1"> <thead> <tr> <th></th> <th>Beginning</th> <th>Ending</th> </tr> </thead> <tbody> <tr> <td>Profit</td> <td>%</td> <td>%</td> </tr> <tr> <td>Loss</td> <td>%</td> <td>%</td> </tr> <tr> <td>Capital</td> <td>%</td> <td>%</td> </tr> </tbody> </table>		Beginning	Ending	Profit	%	%	Loss	%	%	Capital	%	%
	Beginning	Ending											
Profit	%	%											
Loss	%	%											
Capital	%	%											
	Check if decrease is due to sale or exchange of partnership interest <input type="checkbox"/>												
K	Partner's share of liabilities:												
	<table border="1"> <thead> <tr> <th></th> <th>Beginning</th> <th>Ending</th> </tr> </thead> <tbody> <tr> <td>Nonrecourse</td> <td>\$</td> <td>\$</td> </tr> <tr> <td>Qualified nonrecourse</td> <td></td> <td></td> </tr> </tbody> </table>		Beginning	Ending	Nonrecourse	\$	\$	Qualified nonrecourse					
	Beginning	Ending											
Nonrecourse	\$	\$											
Qualified nonrecourse													

Final K-1 Amended K-1

651121

OMB No. 1545-0123

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items			
1	Ordinary business income (loss)	14	Self-employment earnings (loss)
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	15	Credits
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital	16	Schedule K-3 is attached if checked <input type="checkbox"/>
4c	Total guaranteed payments	17	Alternative minimum tax (AMT) items
5	Interest income		
6a	Ordinary dividends		
6b	Qualified dividends	18	Tax-exempt income and nondeductible expenses
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)	19	Distributions
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain	20	Other information
10	Net section 1231 gain (loss)		
11	Other income (loss)		
12	Section 179 deduction	21	Foreign taxes paid or accrued
13	Other deductions		

REVISED DRAFT WHITE PAPER

- Available on the project webpage here:
<https://www.mtc.gov/wp-content/uploads/2023/09/White-Paper-on-Guaranteed-Payments-Final-Version-August-31-2023.pdf>



State Tax Sourcing of Certain Guaranteed Payments Made to Individual Partners for Services

Multistate Tax Commission

DRAFT – AUGUST 31, 2023

FOR DISCUSSION PURPOSES ONLY

SOURCING AS DISTRIBUTIVE SHARE

Prevents “elective” sourcing—by partners agreeing to receive guaranteed payments instead of distributive share, without changing economic results or risk.

Avoids need to distinguish payments for services versus use of capital or special allocations—which can be difficult.

Simplifies partnership withholding—since the partnership may not know where the services were performed.

States may wish to include guaranteed payments as part of the PTE tax base and source them at the entity level.

Sourcing the same as distributive share is the majority rule.

SOURCING AS COMPENSATION

Is more consistent with the entity approach which Subchapter K generally applies to such payments.

Avoids need to distinguish guaranteed payments for services from payments to partners not acting in the capacity of a partner—which may be difficult.

The risk partners will use guaranteed payments to shift the sourcing of income is lessened by the treatment of such payments under Subchapter K.

Is more consistent with the federal sourcing for partners working overseas.

PROPOSED RECOMMENDATIONS

1. Explicitly address the sourcing of guaranteed payments in order to avoid uncertainty.
2. Source guaranteed payments the same whether imposing tax on the partner on a pass-through basis or on the entity.

**PROPOSED
RECOMMENDATIONS
(CONT'D)**

3. If sourcing as distributive share, also:
 - a. Address whether this applies to individuals working in foreign jurisdictions and provide any adjustments if necessary.
 - b. Address whether state follows federal treatment in distinguishing guaranteed payments for services from partner-partnership transactions.
 - c. Specify that this sourcing treatment does not apply to payments made to retired partners required to be sourced to residence under 4 U.S.C. §114.

**PROPOSED
RECOMMENDATIONS
(CONT'D)**

4. If sourcing as compensation, also:
 - a. Impose appropriate limits to ensure that the payments are genuinely similar to compensation for services and avoid income shifting.
 - b. Address whether state follows federal treatment in distinguishing guaranteed payments from distributive share/distributions.
 - c. Address whether state follows federal treatment in distinguishing guaranteed payments for services versus for use of capital.

**PROPOSED
RECOMMENDATIONS
(CONT'D)**

5. To mitigate the possibility of multiple taxation, consider provisions that might grant additional credits to residents who can show that they paid tax on more than 100% of their guaranteed payments based on different state sourcing rules.



QUESTIONS –

1. Should the MTC recommend a particular sourcing approach?
2. Should we draft a model for that approach?

SOURCING OF INVESTMENT PARTNERSHIP INCOME

Available on the project webpage, here: <https://www.mtc.gov/wp-content/uploads/2023/06/Investment-Partnership-Model-6-15-23-1.pdf>



State Tax Treatment of Investment Partnerships Proposed Draft Rule - Regulation Form

Prepared by MTC Staff for Discussion by the Partnership Work Group
June 15, 2023

NOTE ON DRAFT OF RULE IN REGULATION FORM

The model rule for sourcing investment partnership income previously circulated was in a form that could be adopted as a statute. Subsequent discussions, however, indicate that the basis for the rule is well-enough established that it could be adopted as a regulation. Drafting the rule as a regulation has other advantages. The goal here is to provide greater certainty in certain fact-specific situations, which is what regulations are typically used for. States that currently have explicit statutory provisions could also adopt the rule in regulation form. And, unlike statutes, regulations may include examples, which would be very useful here.

BACKGROUND

This summary will assist the review of the model regulation, which follows below.

General Sourcing Issue:

How should income of partnerships engaging primarily in investment activities be sourced?

Work Group Process to Date:

So far, the MTC work group on the taxation of partnerships has:



SOURCING OF INVESTMENT PARTNERSHIP INCOME

- Scope – Individual investors.
- Question – When do the operations of the investment partnership in the state affect the sourcing of income of the partners of that partnership?

WHY REGULATION FORM

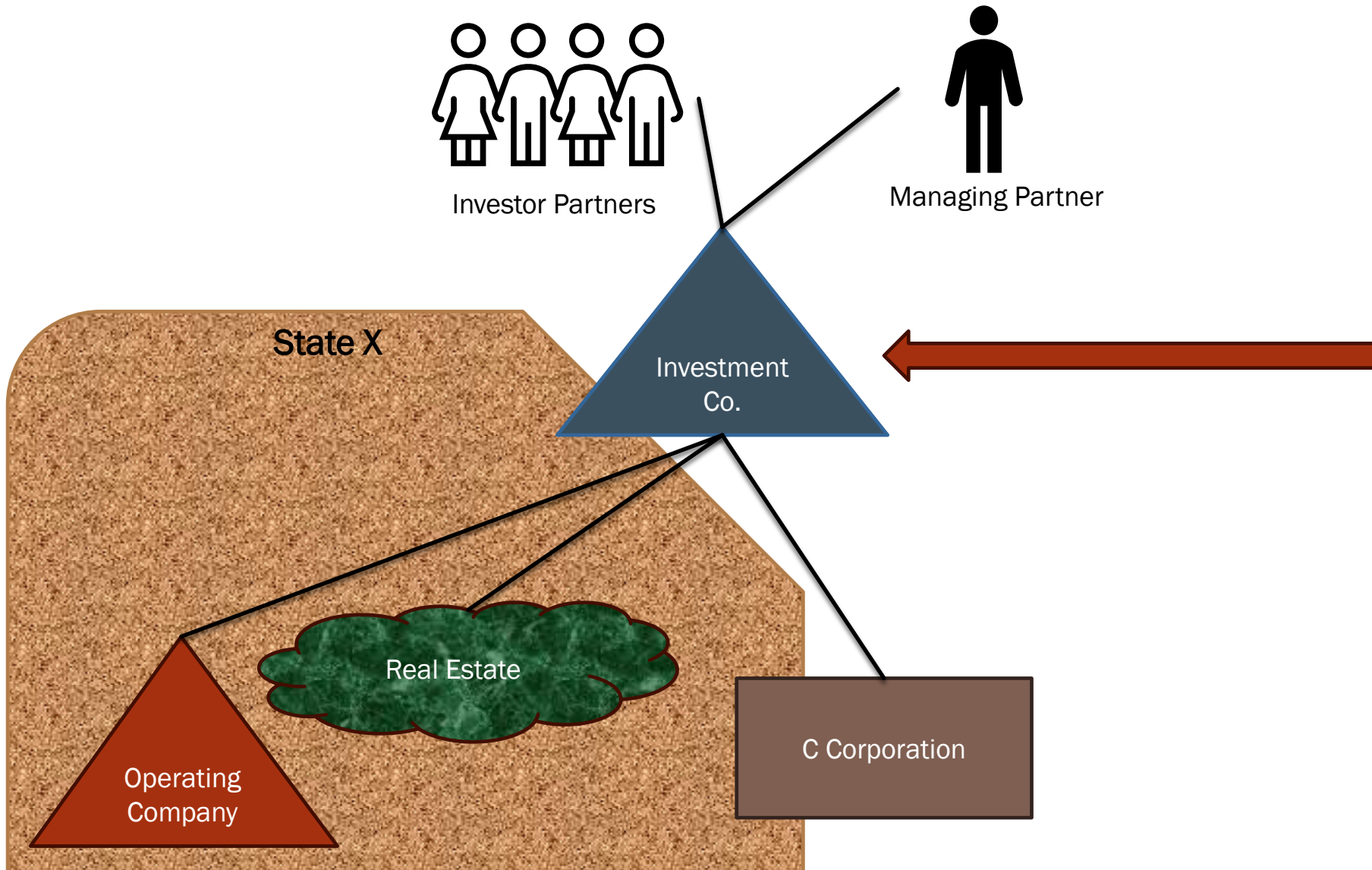
Treatment is supported by existing state law.

The goal here is to provide greater certainty in certain fact-specific situations, which is what regulations are typically used for.

States that currently have explicit statutory provisions could also adopt the rule in regulation form.

And, unlike statutes, regulations may include examples, which would be very useful here.

SOURCING OF INVESTMENT PARTNERSHIP INCOME



Meets the definition of a qualified investment partnership.

CHANGED TO DEFINITION OF QUALIFIED INVESTMENT PARTNERSHIP

- Definition:

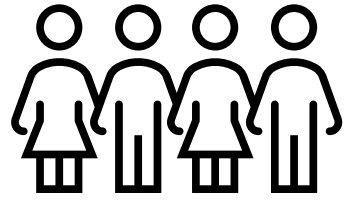
(c) “Qualified Investment Partnership.”

A qualified investment partnership, as used in this regulation, means a partnership that:

- (1) does not act as a dealer under 26 U.S.C. § 475(c);
- (2) does not act as a financial institution as defined by [reference to state law]; and
- (3) holds assets solely for investment purposes and neither materially participates or otherwise actively engages in the activities of the businesses in which it holds interests nor uses or employs assets in any way other than for investment.

- Asset test is now a safe harbor.

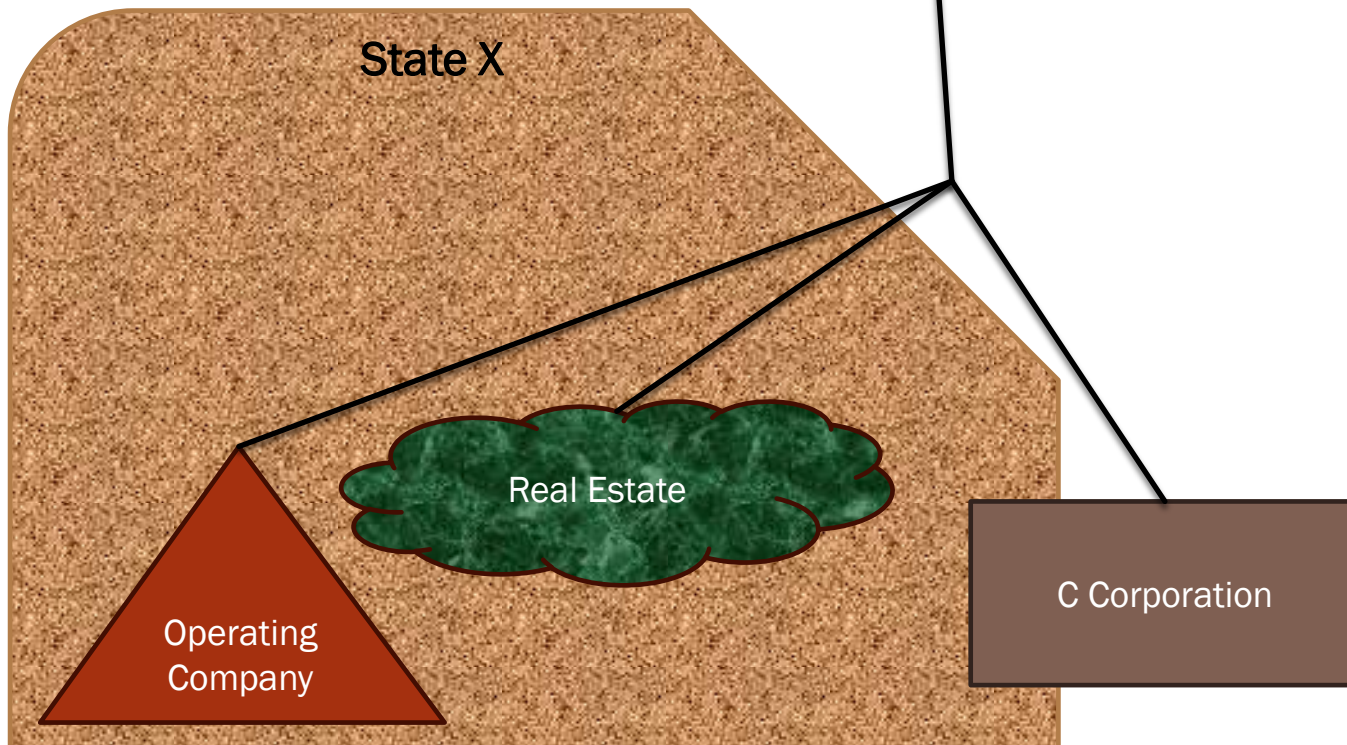
SOURCING OF INVESTMENT PARTNERSHIP INCOME



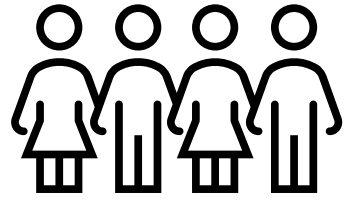
Investor Partners



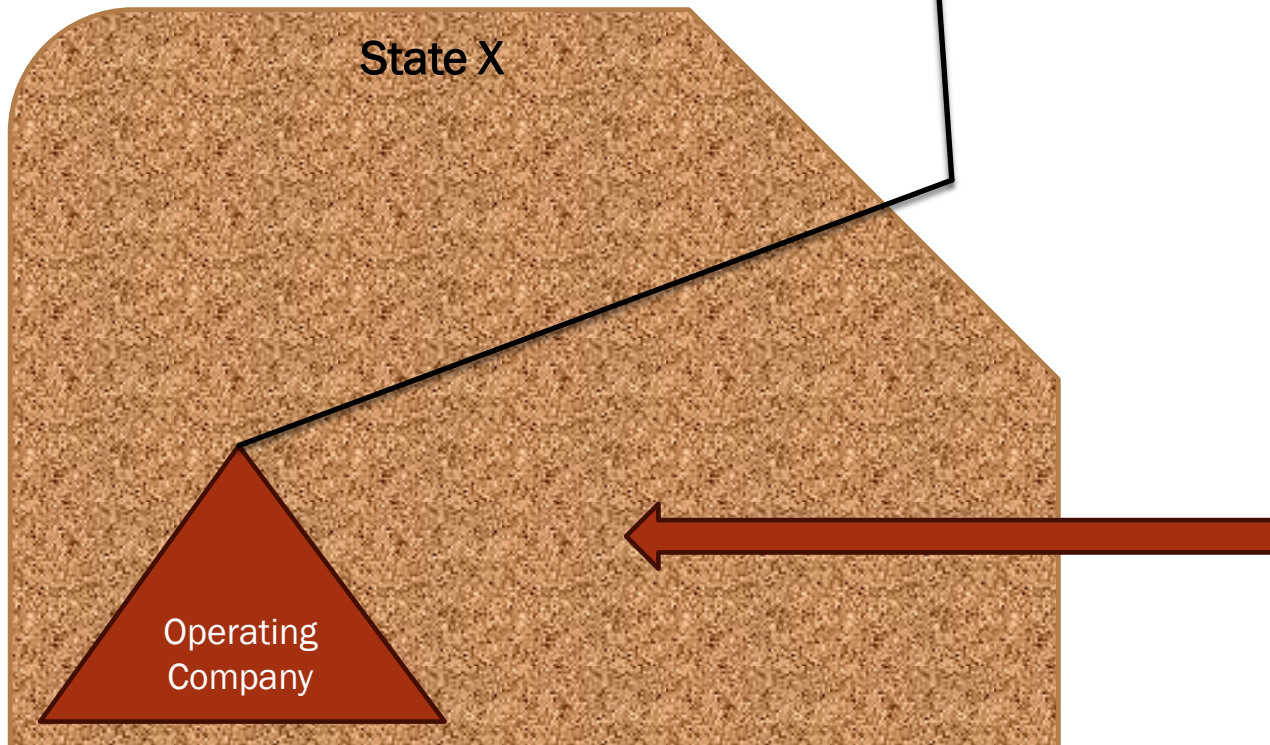
Individual investor partners are treated as if they owned the QIP assets directly and source their distributive share of the related income the same as if that were the case.



SOURCING OF INVESTMENT PARTNERSHIP INCOME

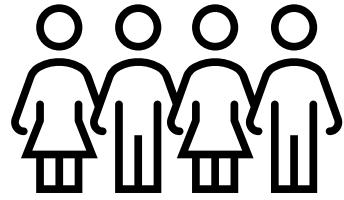


Investor Partners

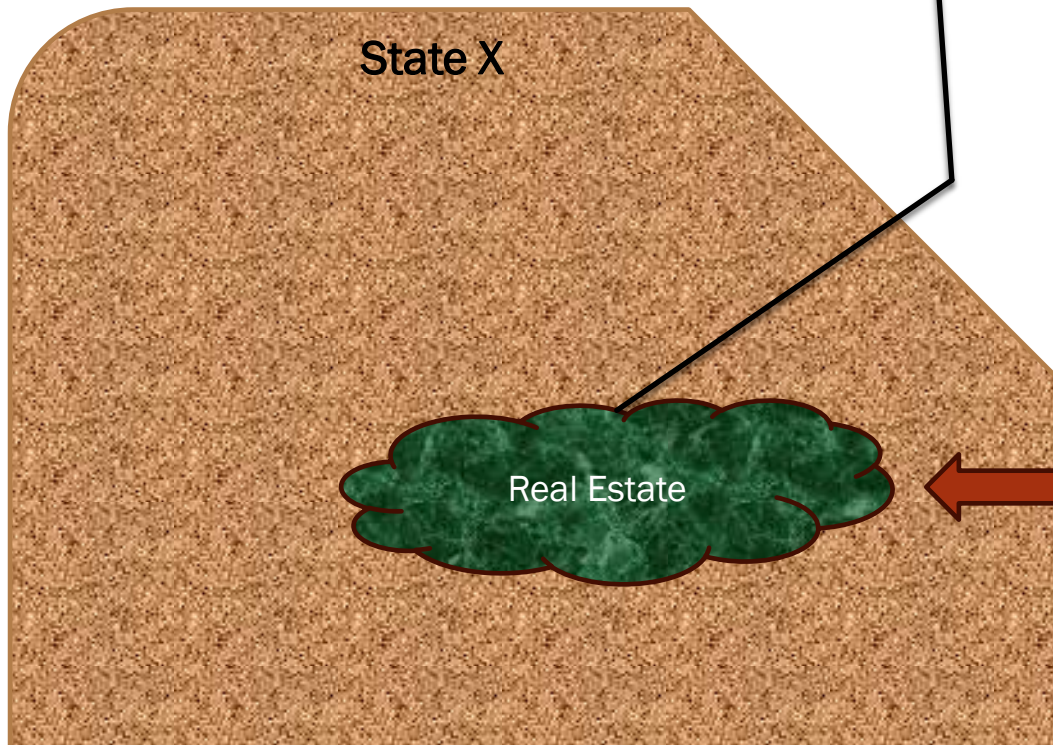


Distributive share income from the Operating Company partnership that flows through the QIP is sourced by the investor partners as if they owned the interest in that partnership directly—that is—to State X.

SOURCING OF INVESTMENT PARTNERSHIP INCOME

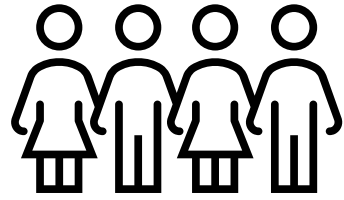


Investor Partners



Rental income from real estate that flows through the QIP is sourced by the investor partners as if they owned the real estate directly—that is—to State X.

SOURCING OF INVESTMENT PARTNERSHIP INCOME



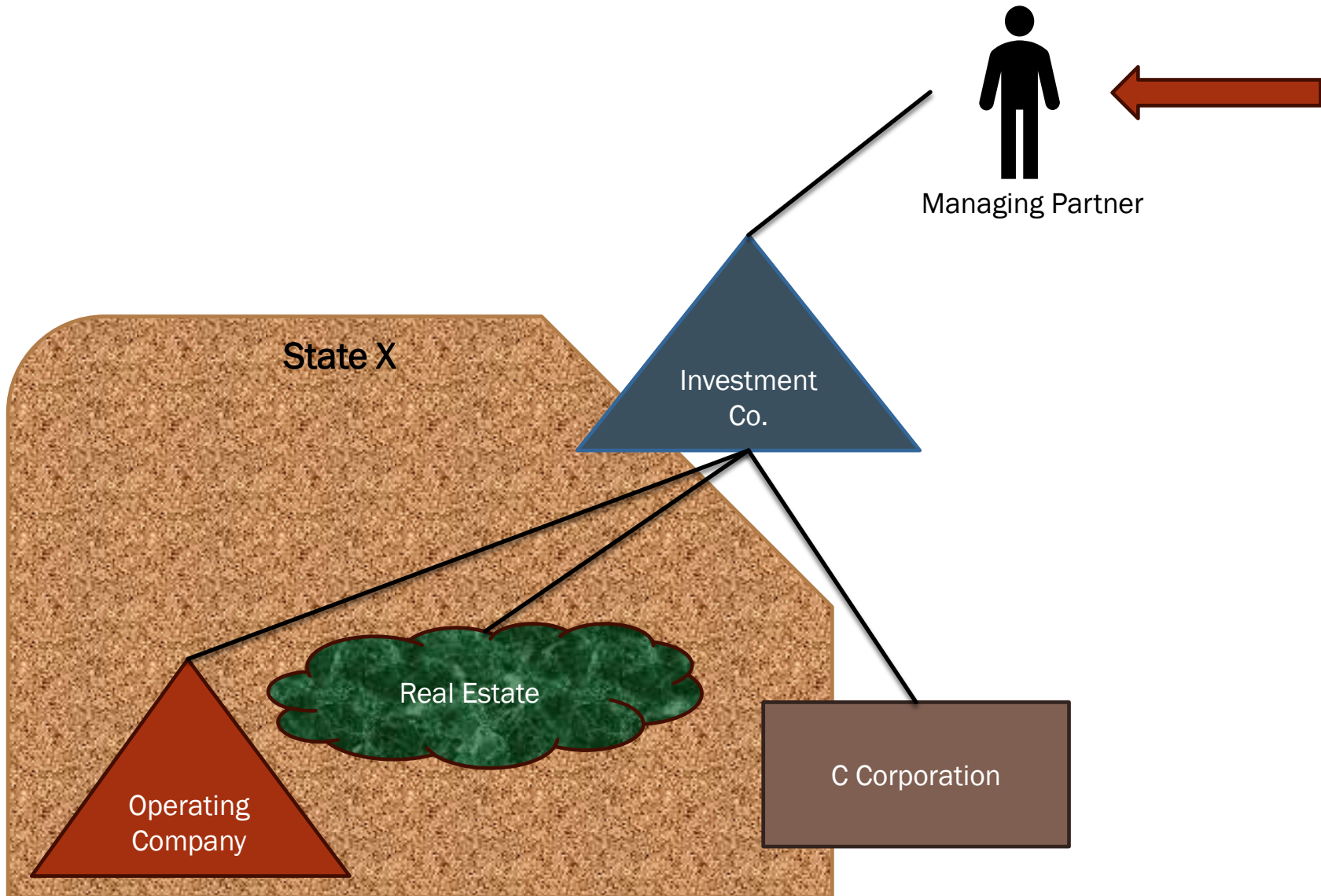
Investor Partners

State X

C Corporation

Dividends from stock that flow through the QIP are sourced by the investor partners as if they owned that stock directly—that is—to their state of residence.

SOURCING OF INVESTMENT PARTNERSHIP INCOME



The managing partner or other partners performing services of the QIP look to information related to its activities (factors, etc.) to source their income.



NEXT STEPS

- Guaranteed payments
- Income from investment partnerships
- Statement of principles – based on the work so far
 - High level
 - Nexus and jurisdiction and basic sourcing principles