



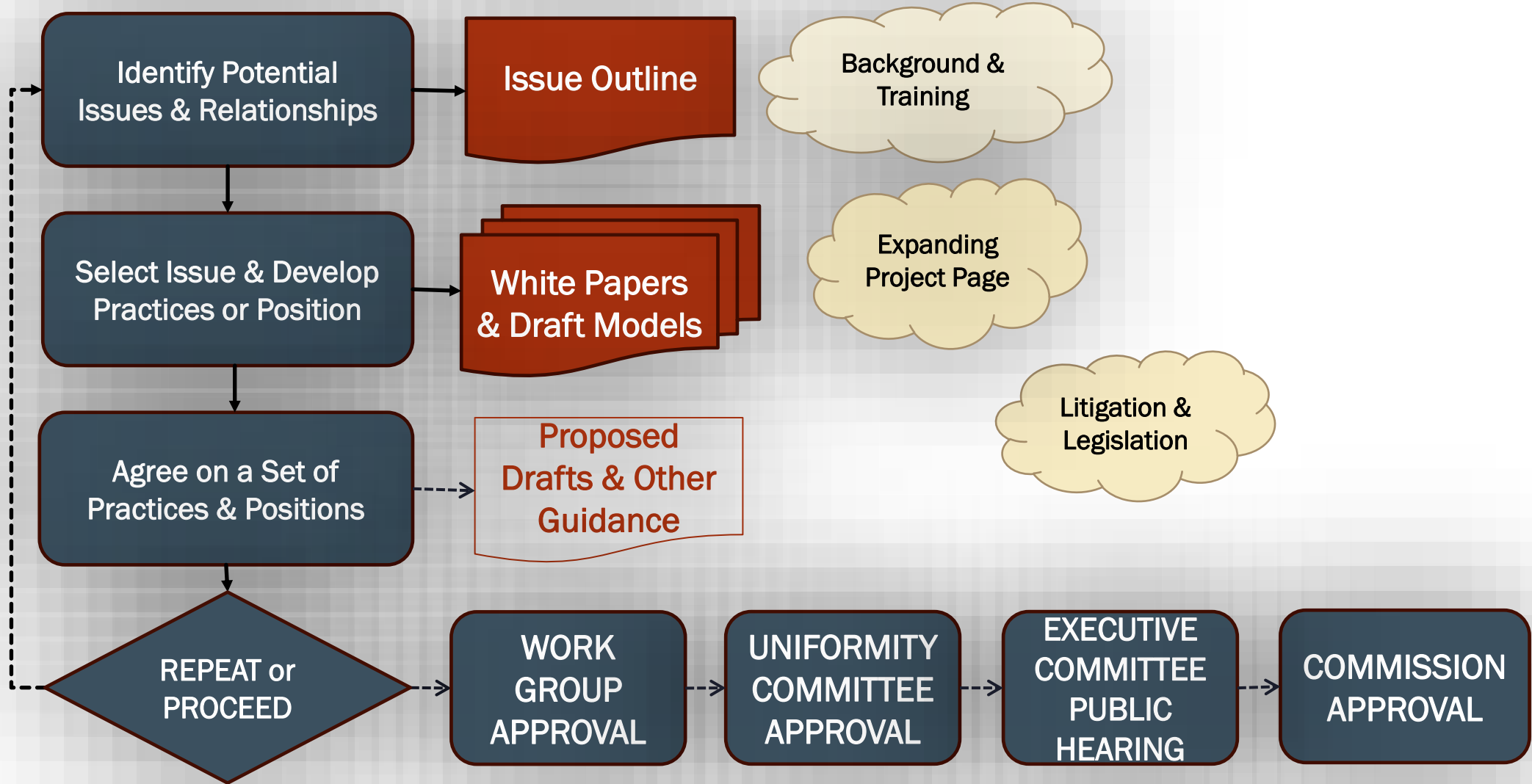
State Taxation of Partnerships – Status Report and Plan for 2024

JANUARY 17, 2024

STATUS - OVERVIEW

- Last meeting – October 18, 2023
 - Topics –
 - Sourcing of guaranteed payments for services – Draft White Paper and Draft Model Rules – sourcing guaranteed payments in the same way as the state sources distributive share
 - Sourcing of income of investment partnerships – Draft White Paper and Draft Model Rules – income is sourced based on the character of the income as though partners had earned it directly
 - Proposal to consider a general framework to guide ongoing sourcing work
- Status report to the Uniformity Committee – November 14, 2023
- Regular meeting – December 20, 2023 – cancelled

General Work Group Process



WHY INVESTMENT PARTNERSHIPS?

- According to latest IRS Data by sector – the Finance & Insurance, Real Estate, and Holding Company sector categories (roughly the sectors that contain “investment partnerships”) have:
 - Over 60% of all partnership net income (loss)
 - Over 65% of the total partners
 - Over 80% of all partnership assets
- About half of the states had some kind of rules addressing “investment partnerships”
- These can be complicated tiered partnership structures that provide funding to operating partnerships deriving business income from the state
- Conflicting state rules can lead to multiple taxation or “nowhere” income

WHY GUARANTEED PAYMENTS FOR SERVICES?

- According to latest IRS data:
 - Partnerships pay out \$88 billion in guaranteed payments for services
 - Federal tax and other rules affecting sourcing at the international and state level
 - About half of the states have a specific rule addressing sourcing of guaranteed payments for services
 - Majority – source the same as distributive share
 - Minority – source to the location of the services
 - Conflicting state rules can lead to multiple taxation – which might be relieved through a “generous” credit for taxes paid

WHY A “PROPOSED GENERAL FRAMEWORK?”

- Long answer – important factors affect state sourcing of partnership income –
 - State law – governing formation and legal treatment of partnerships
 - Constitutional limits – as applied to jurisdiction/nexus over partners
 - Federal conformity – Subchapter K and to the federal substantive tax law
 - State sourcing rules – that look to business income of the unitary business
 - These concepts are hard to apply where the tax is imposed on a pass-through basis
 - Federal rules may not be sufficient to prevent state income shifting
- Short answer – complexity

INFORMATION ON THESE TOPICS (AND MORE) –

MTC PROJECT PAGE –

[HTTPS://WWW.MTC.GOV/UNIFORMITY/PROJECT-ON-STATE-TAXATION-OF-PARTNERSHIPS/](https://www.mtc.gov/uniformity/project-on-state-taxation-of-partnerships/)

The screenshot shows the MTC website's project page for "State Taxation of Partnerships". At the top, there is a navigation bar with the MTC logo and a search bar. Below the navigation bar, the page title "State Taxation of Partnerships" is displayed. The main content area is divided into several sections:

- Project Description:** A paragraph explaining the project's purpose and a list of topics to be discussed, including partnership operating issues, tax treatment, and reporting requirements.
- Upcoming Meeting Notice:** A section with two columns: "Agenda and Materials" and "Dial-In/Log-In Information". The agenda lists items like "Welcome and Introductions", "Public Comments", and "Business". The dial-in information provides contact details for the meeting.
- Project Materials:** A section titled "Latest Documents – By Subject" with a list of documents, each with a red dot icon indicating it is available for download.
- Additional Background Information:** A section with three buttons: "General Research and Analysis", "Partnership Tax Reporting & Audit Rules", and "State Pass-Through Entity (PTE) Taxes".
- Prior Meeting Agendas, Materials, and Notes:** A section with a list of links to previous meeting materials, including agendas, reports, and notes from various dates (e.g., October 18, 2023; September 28, 2023; July 18, 2023; June 21, 2023; May 21, 2023).

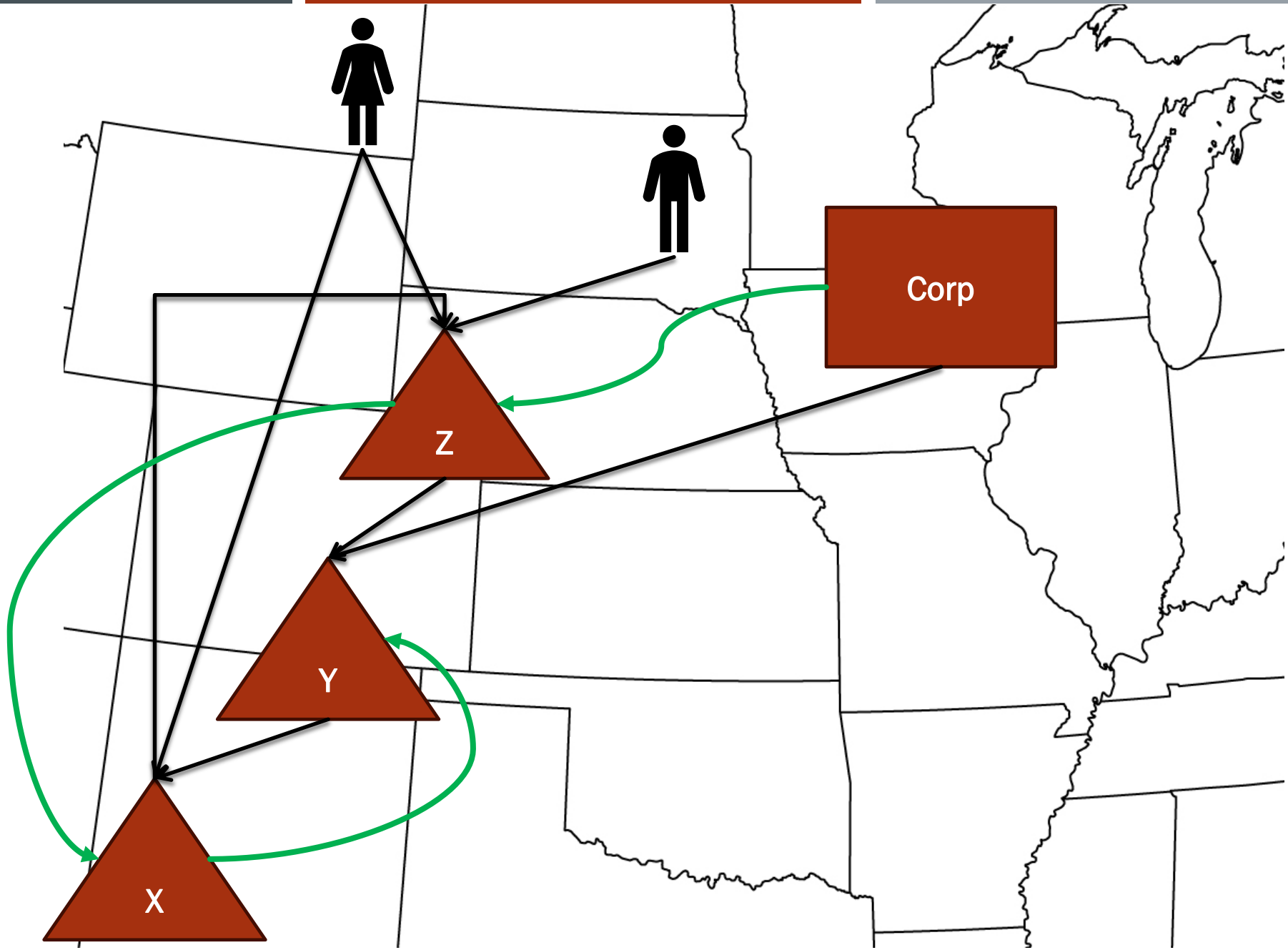
WHAT'S NEXT?

- **Sourcing of income in tiered structures:**
 - Application of general state sourcing rules—including formulary apportionment, unitary business principle, etc.
 - Treatment of related-entity transactions
 - Treatment of complex special allocations

SIMPLE EXAMPLE

Ownership
→

Transactions
→



NEXT STEPS

- Research what states have done to address sourcing of partnership income in tiered structures generally
- Compile and publish information to help determine if the general framework is realistic and represents state policy
- Work through specific examples of how sourcing may be addressed

SPEAKING OF COMPLEXITY

- New Report on the Prevalence of Circular Partnerships –
 - Generally concludes that “trapped income” may not be as great as feared
 - But also concludes that circular partnership structures pose serious compliance and enforcement challenges that the current law may be inadequate to address
 - Of course—does not address the issues such structures pose for state sourcing

(See on our General Research and Analysis Sub-Page – here: https://www.mtc.gov/uniformity/project-on-state-taxation-of-partnerships/general-research-analysis/?et_fb=1&PageSpeed=off.)



NEW BUSINESS?

- Vice Chair Volunteer
- Work Group Process – schedule for the upcoming year, presentations or information that may be helpful, etc.
 - States - let staff know if there are folks we should include as “regular participants”
 - Members of the public – we always welcome your input on process as well
- Other