

## STATE RULES ON TIERED PARTNERSHIPS

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*This document draft sets forth examples of state sourcing, withholding/return, and PTE tax rules relevant to tiered partnerships. This information comes from state statutes, regulations, cases, form instructions, and guidance as of the date of this draft. This information should not be relied on as tax advice. For specific questions, taxpayers should contact the applicable state department of revenue or their tax advisor. If you have any updates or changes for your state to the information listed below, please contact Jenn Stosberg at [jstosberg@mtc.gov](mailto:jstosberg@mtc.gov)*

### Alabama

#### Ala. Admin Code r. 810-27-1-.09(3) *Sourcing*

For taxpayers with a business interest in an unincorporated entity (e.g., partnership, unincorporated joint-venture, limited liability company taxed as a partnership, etc.), the apportionment formula shall include the pro rata share of the unincorporated entity's factor data.

#### Ala. Code § 40-18-24.2(c)(1) *Withholding/Return*

The pass-through entity shall be liable to the State of Alabama for the payment of the tax required to be remitted under this section, together with applicable interest and penalties, but shall not be liable to any such member for any amount withheld from distributions to or the distributive share of such member and remitted in compliance with this section. A member of a pass-through entity that is itself a pass-through entity, a lower-tier pass-through entity, shall be subject to the same requirement to file a composite income tax return with respect to the distributive share of the apportioned and allocated income of the lower-tier pass-through entity. The Department of Revenue shall apply the Alabama income tax remitted by a pass-through entity on behalf of the lower-tier pass-through entity to the remittance obligation imposed by this subsection on the lower-tier pass-through entity.

#### Ala. Rev. Rul. 07-001 (10/15/2007) *Withholding/Return*

A subchapter K entity is permitted to file one Alabama aggregate composite return on behalf of all nonresident partners/owners of the entity, including corporations and other flow-through entities, as well as "upper tier owner" individuals and entities.

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### Alaska

#### Alaska Form 6900 Instructions from 2022 *Sourcing*

A partnership is required to file Form 6900, even if the partnership itself does not conduct business in the state, but owns a partnership interest in a lower-tier partnership doing business in the state, because of the attribution rule . . . Nexus is sometimes referred to as "doing business" within the state. It is the act of conducting business activity within the state during the tax year. It may exist as a result of an entity's direct activity, the activity of its employees or agents, or through its interest in a lower-tier partnership or LLC . . . A lower-tiered partnership is required to file Form 6900 if it has nexus in Alaska and any partner is a corporation or another partnership, even if the partners of the higher-level partnership are all natural persons or those effectively treated as natural persons . . . Indicate whether the partnership has an ownership interest in any foreign partnership. Attach a schedule showing the name, EIN, and the

ownership percentage held of each foreign partnership. If the foreign partnership has an ownership interest in a foreign corporation, the ownership is attributed to the upper-tier partnership, including all tax attributes such as apportionment factor . . . If you answered yes to question 1c on page 1 of Form 6900, then the amounts in Schedule A, column A must include amounts attributed to the partnership from lower-tier partnerships.

Alaska Admin. Code tit. 15, § 20.320(a) *Sourcing*

The income, expenses, assets, and apportionment factors of an enterprise involving undivided joint ownership must be attributed to the joint owners of that enterprise on the basis of their respective ownership interests, as may be modified by agreement among those joint owners. For purposes of this section, partnerships, joint ventures, trusts with joint beneficiaries and similar legal entities but not a single corporation, are enterprises involving undivided joint ownership.

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## Arizona

Ariz. Rev. Stat. Ann. § 43-306 *Sourcing*

The allocation and apportionment of income of a partnership that has nonresident partners shall be made pursuant to chapter 11, article 4 of this title.

Ariz. Admin. Code § R15-2G-101 *Sourcing*

“Arizona distributive share of the partnership” means the amount computed in subsection (A)(1). Subject to the allocation and apportionment provisions of A.R.S. sections 43-1131 through 43-1148.

Arizona Corporate Tax Ruling No. 93-9 (04/30/1993) *Sourcing*

A multistate corporation that has a partnership interest in a partnership that is a partner in a tiered partnership must also report its ultimate distributive share of the tiered partnership's income or loss from Arizona activities.

Example:

Partnership A has a 50% apportionment ratio for its Arizona operations. Partnership B has a 25% interest in Partnership A. Corporation C has a 10% interest in Partnership B. Partnership B does not have any other connection with Arizona other than its partnership interest. Corporation C has business activities within and without Arizona in addition to its partnership interest in a partnership that is a partner in a tiered partnership.

Corporation C must file an Arizona corporate income tax return apportioning its income from business activities within and without Arizona. Corporation C must also report its ultimate distributive share of Partnership A's Arizona income, loss, gain and other items. If Corporation C has a business partnership interest in Partnership B, the corporation will apportion its income or loss from the tiered partnership. If Corporation C has a nonbusiness partnership interest in Partnership B, the corporation will allocate its income or loss from the tiered partnership.

Arizona Corporate Tax Ruling No. 93-10 (04/30/1993) *Sourcing*

A corporation that does not have any connection with Arizona, other than a partnership interest in a partnership that is a partner in a tiered partnership, must apportion or allocate its ultimate distributive share of the tiered partnership's income or loss from

Arizona activities. If the corporation's interest in the tiered partnership is business, the numerator and denominator of the corporation's apportionment factors in the Arizona tax return would include the corporation's distributive share of the tiered partnership's factors. The allocation of a tiered nonbusiness partnership's income or loss in the corporation's Arizona tax return would reflect the corporation's ultimate distributive share of the tiered partnership's Arizona activities.

A multistate corporation that has business activities within and without Arizona must apportion its income from such activities in addition to the apportionment or allocation of its ultimate distributive share of the tiered partnership's income or loss from Arizona activities. If the corporation's interest in the tiered partnership is business, the numerator and denominator of the corporation's apportionment factors in the Arizona tax return would include the corporation's distributive share of the tiered partnership's factors. The allocation of a tiered nonbusiness partnership's income or loss in the corporation's Arizona tax return would reflect the corporation's ultimate distributive share of the tiered partnership's Arizona activities.

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## Arkansas

### Ark. Code Ann. § 26-51-802(c) *Sourcing*

A partnership that files an Arkansas partnership return and has income from both within and without Arkansas shall apportion income to Arkansas under the Uniform Division of Income for Tax Purposes Act, § 26-51-701 et seq.

Subject to the provisions of § 26-51-202(e), all partnership income from activities within this state that is reflected on a partnership return shall be allocated to this state.

### Ark. Corp. Inc. Tax Regs. 1.26-51-802(b) *Sourcing*

Any taxpayer with an interest in a partnership which has gross income from sources within Arkansas must directly allocate the partnership's Arkansas income to Arkansas, rather than include partnership income and apportionment factors in the taxpayer's apportionment formula.

### Ark. Code Ann. § 26-65-103(b)(3) *PTE*

An affected business entity that is a member of another affected business entity shall subtract its distributive share of the income or add its distributive share of the loss from the other affected business entity to the extent that the income or loss was derived from or connected with sources within this state.

### Ark. Code Ann. § 26-51-919 *Withholding/Return*

(a)(1) Lower-tier pass-through entity” means a member of a pass-through entity that is itself a pass-through entity

(a)(4)(B)(1)(b)(i) A lower-tier pass-through entity shall withhold and pay income tax on the share of income distributed by the lower-tier pass-through entity to each of its nonresident members.

(a)(4)(B)(1)(b)(ii) The secretary shall apply the tax withheld and paid by a pass-through entity on distributions to a lower-tier pass-through entity to the withholding required of that lower-tier pass-through entity.

### Arkansas Rule 2006-3 *Withholding/Return*

Withholding is not required “when a pass-through entity is making distributions to another pass-through entity. Provided however, the exception set out in this paragraph does not relieve the lower-tiered pass-through entity from the duty to withhold on distributions it makes which are not otherwise exempt”

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## California

### Cal. Code Regs. tit. 18, § 25137-1 *Sourcing*

When a taxpayer has an interest in a partnership as defined in Section 17008, Revenue and Taxation Code, the division of its distributive share of partnership items shall be determined in accordance with Chapter 10 of Part 10 of Division 2 of the Revenue and Taxation Code. The determination of the portion of such distributive share (constituting business and nonbusiness income) which has its source in this state or which is includible in the taxpayer's business income subject to apportionment, shall be made in accordance with these regulations provided that the taxpayer, or the partnership, or both, have income from sources within and without this state. The taxpayer in computing net income for its taxable year shall include its distributive share of partnership items referred to above for any partnership year ending within or with the taxpayer's taxable year. The same principle applies when a taxpayer has an interest in a partnership that itself owns an interest, directly or indirectly, in one or more other partnerships.

The first step is to determine which portion of the taxpayer's income and its distributive share of the partnership items constitute “business income” and “nonbusiness income” under Section 25120, Revenue and Taxation Code, and the regulations thereunder. The various items of nonbusiness income are then directly allocated to specific states pursuant to the provisions of Section 25124 to 25127, Revenue and Taxation Code. The taxpayer's distributive share of partnership business income is apportioned by the formula set forth in subsections (f) or (g), whichever is applicable. Even if the partnership's business and the taxpayer's business are not unitary, such that subsection (g) applies, the distributive share of income allocated to the taxpayer is from a separate trade or business of the taxpayer, not nonbusiness income of the taxpayer. The determination of whether an item of income is apportionable business income or allocable nonbusiness income is made at the partnership level based on the trade or business of the partnership. Revenue and Taxation Code section 23040 is not applicable. The sum of (1) the items of nonbusiness income directly allocated to this state, plus (2) the amount of business income attributed to this state is the portion of the taxpayer's entire net income which is subject to tax.

Income arising from transactions and activity in the regular course of the partnership's trade or business constitutes business income. Thus, a corporate-partner's distributive share of partnership business income constitutes business income to the corporate-partner, but the determination of whether the partnership's activities and the activities of the corporate-partner constitutes a single trade or business or more than one trade or business turns on the facts in each case. If the partnership's activities and the taxpayer's activities constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be combined with the taxpayer's trade or business as constituting a single trade or business . . . When the activities of the partnership and the taxpayer do not constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be treated as a separate trade or business of the taxpayer.

(f) If the partnership's activities and the taxpayer's activities constitute a unitary business under established standards, disregarding ownership requirements, the business

income of such single trade or business attributable to this state shall be determined by an apportionment formula, pursuant to either Section 25128, Section 25128.5 or Section 25128.7, Revenue and Taxation Code, whichever is applicable, of the taxpayer and its share of the partnership's factors for any partnership taxable year ending within or with the taxpayer's taxable year . . .

(f)(3)(A) The partnership's sales which give rise to business income, shall be included in the denominator of the taxpayer's sales factor to the extent of the taxpayer's interest in the partnership. The amount of such sales attributable to this state shall also be included in the numerator of the taxpayer's sales factor. Intercompany sales between the partnership, on the one hand, and the taxpayer or any member of the taxpayer's combined reporting group, on the other, shall be eliminated from the denominator of the taxpayer or the taxpayer's combined reporting group (if applicable), as well as the numerator of the taxpayer's sales factor or the numerator of another member of the taxpayer's combined reporting group, whomever made the sale to the partnership, as follows:

(i) Sales by the taxpayer, or any member of the taxpayer's combined reporting group, to the partnership to the extent of the taxpayer's interest in the partnership.

(ii) Sales by the partnership to the taxpayer, or any member of the taxpayer's combined reporting group, not to exceed the taxpayer's interest in all partnership sales.

(f)(3)(B) Notwithstanding any intercompany eliminations described in subparagraph (A) above, sales made to nonpartners, other than members of the partner taxpayer's combined reporting group, shall be included in the denominator of the taxpayer's sales factor in an amount equal to such taxpayer's interest in the partnership.

(g) When the activities of the partnership and the taxpayer do not constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be treated as a separate trade or business of the taxpayer.

Cal. Code Regs. tit. 18, § 17951-4(d) *Sourcing*

If a nonresident is a partner in a partnership which carries on a unitary business, trade or profession within and without this state, the source of the partner's distributive share of partnership income derived from sources within this state shall be determined in the manner described below.

- (1) Except as provided, the total business income of the partnership shall be apportioned at the partnership level in accordance with the apportionment rules of the Uniform Division of Income for Tax Purposes Act, Sections 25120 to 25139, Revenue and Taxation Code, and the regulations thereunder. Each partner's distributive share of the partnership business income apportioned to this state is income derived from sources within this state.
- (2) If the partnership and the business activity of the partner are part of one unitary business, then the rules of Title 18, Cal. Code Regs., § 25137-1(f) apply and the apportionment of the partnership business income is done at the partner level for the unitary partner or partners. Each partner's distributive share of the partnership business income apportioned to this state is income derived from sources within this state.
- (3) The source of guaranteed payments received by a nonresident partner from a partnership shall be determined as if the guaranteed payments were a distributive share of partnership business income.
- (4) The source of a partner's distributive share of items which do not constitute business income shall be determined in accordance with the sourcing rules of Sections 17951 through 17955, Revenue and Taxation Code, and the regulations

thereunder, as if the income producing activity were undertaken by the partner in its individual capacity.

- (5) Except as provided in subsection (d)(6), the business activity of a partnership will not ordinarily be considered part of a unitary business with another business activity of one or more of its partners. However, if necessary to properly reflect the income or loss of the partnership or its partners, the Franchise Tax Board shall have the discretion to treat the business activity of a partnership and a business activity of one or more of its partners as part of a single unitary business, but only after conducting a comparable uncontrolled price examination in the manner provided by Section 23801(d)(1), Revenue and Taxation Code. For this purpose, the term "business activity" includes the partner's interest in the business activity of a sole proprietorship, another partnership, a limited liability company and an S corporation. If the Franchise Tax Board determines that unitary combination is appropriate under this subsection, the business income of the unitary activity shall be apportioned in accordance with the rules prescribed under subsection (d)(6)(A), without regard to the 20 percent limitation described therein.
- (6) Exception for 20 percent or more interests. Subsection (d)(5) shall not apply to partners who own, directly or indirectly, a 20 percent or more capital or profits interest in a partnership. For purposes of this section, the ownership of a capital or profits interest in a partnership shall be determined under the rules of subsection (d)(6)(B).

*Appeal of Smith, California Office of Tax Appeals Decision No. 20036033 (Dec. 7, 2022) Sourcing*

Applies Cal. Code Regs. tit. 18, § 25137-1 to a tiered partnership. The partnership's apportionment factors flowed through to the pass-through holding company partner.

*California FTB Legal Ruling No. 2021-01 Sourcing*

Analyzes whether pass-through entity holding companies are unitary with other pass-through entities in various situations.

"Lastly, one must not forget that, as discussed above, traditional tests for unity are not an exact fit in the context of pass-through entity holding companies. The traditional unitary tests were concerned with the extent to which the income and factors of disparate corporate affiliates could be combined and used to apportion income. In the corporate context, all factors and income of unitary entities are combined. However, with pass-through interests, an entity is unitary only to the extent of its interest in the pass-through entity. Therefore if a partner is unitary with a partnership and holds a 25 interest, the partner and 25 percent of the partnerships income and factors are combined. Thus, since not all of the income and factors of a unitary holding company are includable, attributes normally considered insignificant become critical. Therefore, in instances where a pass-through entity holding company holds less than a controlling interest in an operating entity, the holding company can still be unitary with the operating entity, to the extent of its ownership interest in the entity. This is because pass-through entities need not hold more than fifty percent of an entity to be unitary with that entity. As long as unitary indicia, as discussed above, exist, a pass-through entity holding company can be unitary with an operating entity. If a pass-through entity holding company provides value and support to the operating business, it will be properly treated as unitary with that business."

*California PTE Frequently Asked Questions PTE*

Can a qualified entity have a partner, member, or shareholder that is a partnership? Yes

*California Franchise Tax Board Website Withholding/Return*

A lower tier pass-through entity is a pass-through entity with California source income that has a pass-through entity owner. If it withheld tax on behalf of its nonresident owners, it is required to file Form 592-PTE to allocate withholding to each nonresident owner, in accordance with each nonresident owner's interest in the entity.

An upper tier pass-through entity is a pass-through entity's owner that is itself a pass-through entity. If tax has been withheld on behalf of the upper tier pass-through entity by a lower tier pass-through entity, the upper tier pass-through entity is required to file Form 592-PTE to allocate withholding paid on its behalf to each owner, whether a California resident or nonresident, in accordance with each owner's interest in the upper tier pass-through entity.

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## Colorado

### Colo. Rev. Stat. § 39-22-203(1)(a) *Sourcing*

In determining Colorado nonresident federal taxable income of a nonresident partner of any partnership, there shall be included only the portion of such partner's distributive share of items of partnership income, gain, loss, deduction, or credit derived from sources within Colorado determined in accordance with the provisions of section 39-22-109 or, at the partnership's election, apportioned or allocated to this state pursuant to section 39-22-303.5, 39-22-303.6, or 39-22-303.7.

### Colo. Code Regs. § 39-22-109(3)(c) *Sourcing*

Distributive Share of a Member of a Pass-Through Entity. Income received as part of the Nonresident individual's distributive share of a Pass-through entity income, gain, loss, or deduction is Colorado-source income to the extent that the Pass-through entity determines that income is Colorado-source income pursuant to § 39-22-203(1)(a), C.R.S., and the rules promulgated thereunder. These rules apply to all Members of a Pass-through entity regardless of the type of the entity (e.g., limited liability company, limited liability partnership, limited liability limited partnership) or the status of the Member (e.g., limited or general).

(i) A Nonresident has Nexus with Colorado if the Nonresident is a Member of a Pass-through entity doing business in Colorado.

(ii) Character of Income. The activities of a Pass-through entity are attributable to its Members. Therefore, a Member is engaged in a Business in Colorado to the extent the Pass-through entity is engaged in Business in Colorado. The character of the item of income, loss, deduction or credit included in the Member's distributive share is determined as if the item was realized or incurred directly by the Member from the source from which the item was realized by the Pass-through entity or incurred in the same manner as the Pass-through entity. The principles of this paragraph apply in the case of an ownership chain that runs through multiple Pass-through entities.

(iii) A Nonresident Member of a Pass-through entity deriving income from within Colorado and elsewhere has Colorado-source income as determined by § 39-22-109, C.R.S., and this rule, or as determined by § 39-22-303.6, C.R.S., and the rules thereunder if the Pass-through entity elects under § 39-22-203(1)(a), C.R.S., to apportion its income pursuant to § 39-22-303.6, C.R.S.

(iv) A Nonresident Member's share of Colorado-source Business income of a Pass-through entity that elects to apportion its income pursuant to § 39-22-303.6, C.R.S. (including the special apportionment rules adopted thereunder), shall be based on the Member's pro rata share of such Pass-through entity's income multiplied by the Pass-through entity's apportionment percentage.

(v) In the case of a Nonresident who is a Member of a partnership ("first partnership"), which partnership is a partner in another partnership ("second partnership"), the following rules apply:

(A) Unitary Partnerships. In the case of unitary partnerships, the election made by the second partnership is irrelevant to the treatment of income of the first partnership.

(I) If the first partnership makes the election to apportion its income pursuant to § 39-22-303.6, C.R.S. (including the special apportionment rules adopted thereunder), and is unitary with the second partnership as determined by general unitary theory, then the Nonresident member of the first partnership's share of Colorado source income is the Member's pro rata share of the partnership's Colorado-source income as determined by § 39-22-303.6, C.R.S. The first and second partnerships are treated as a single entity for purposes of calculating apportionment under § 39-22-303.6, C.R.S.

(II) If the first partnership makes the election not to apportion its income pursuant to § 39-22-303.6, C.R.S., and is unitary with the second partnership, then the partnerships are treated as one partnership and the income is sourced in accordance with this rule.

(B) Non-Unitary Partnerships. In the case of non-unitary partnerships, the election made by the first partnership is irrelevant to the treatment of income of the second partnership.

(I) If the two partnerships are non-unitary, then regardless of the election made by the first partnership, the first partnership's pro-rata share of the second partnership's Colorado-source income is directly allocated by the first partnership to Colorado and is not apportioned. The pro-rata share of such income passes through to the Nonresident Member as Colorado-source income.

(vi) A Nonresident individual may include as a credit for taxes paid on their Nonresident individual income tax return any payment made on their behalf by a partnership or Subchapter S corporation on a composite return. See §§ 39-22-601 (2.5) and (5), C.R.S.

(vii) Investment Partnerships. A partnership whose sole activity is to buy and sell securities for its own account is not carrying on a Business in Colorado. Therefore, a Nonresident individual partner of such a partnership is not subject to Colorado income tax on their distributive share of such partnership income. § 39-22-109(2)(a)(V), C.R.S. A partnership that engages in other activities in Colorado that are neither the described activities here nor entirely ancillary to such activities is carrying on Business in Colorado.

(viii) Foreign Source Income of an Export Partnership. See, § 39-22-206, C.R.S., for the exclusion of foreign source income of an export partnership from Colorado taxable income.

Colorado Department of Revenue Website (08/14/2023) *PTE*

Tiered partnerships. If a partnership is a partner (an "upper-tier partnership") in another partnership (a "lower-tier partnership") that makes a SALT Parity Act election, the lower-tier partnership must provide the identifying information and income information for the upper-tier partnership. Any refund due to the upper-tier partnership as a result of the SALT Parity Act election made by the lower-tier partnership will be issued to the upper-tier partnership, rather than to its partners.

Colorado DR 0106 Book (2022) *PTE*

If the partnership is a partner (an "upper-tier partnership") in another partnership (a "lower-tier partnership") that made an election for the tax year pursuant to section 39-



22-343, C.R.S., to be subject to tax at the entity level, enter on line 22 the partner's distributive share of the upper-tier partnership's share of the tax calculated and paid by the lower-tier partnership pursuant to section 39-22-344(1), C.R.S.

If the S corporation is a partner in a partnership (a "lower-tier partnership") that made an election for the tax year pursuant to section 39-22-343, C.R.S., to be subject to tax at the entity level, enter on line 22 the shareholder's pro rata share of the S corporation's share of the tax calculated and paid by the lower-tier partnership pursuant to section 39-22-344(1), C.R.S.

If this partnership or S corporation is itself a partner in another partnership (the "lower-tier partnership"), and the lower-tier partnership makes an election under the SALT Parity Act, and pays Colorado income tax, the credit allowed to this partnership or S corporation under section 39-22-347, C.R.S., is reported on this line 32. The lower-tier partnership will list the amount of tax paid on line 15 of the Colorado K-1 (DR 0106K) issued to this partnership or S corporation. If the lower-tier partnership was allocated similar credit from yet another partnership (regardless of whether it made an election), it will report that amount on line 22 of the Colorado K-1 issued to this partnership or S corporation. This line 32 will be the total of the amounts listed on lines 15 and 22 of any Colorado K-1 received from lower-tier partnerships. Include copies of those Colorado K-1 forms with this schedule. Do not include copies of Colorado K-1 forms issued by this partnership or S corporation to its partners or shareholders (refer to the instructions for form DR 0106K for submission instructions). The credit on this line 32 is allocated to partners and shareholders of this partnership in accordance with their distributive or pro rata shares.

#### Colorado FYI Income 54 *Withholding/Return*

In the case of tiered partnership structures, withholding is required only for nonresident members, not for any other pass-through entities involved in the partnership structure. A lower tier partnership may elect to withhold and remit taxes on behalf of an upper tier partnership's nonresident members, but it is not obligated to do so. Rather, the upper tier partnership is responsible for ensuring that the proper withholding is made and remitted for its nonresident members. If a lower tier partnership withholds and remits payment for the upper tier partnership's nonresident members, payment must be remitted with a separate Form DR 0108 for each nonresident member who will ultimately claim the withholding on their Colorado individual income tax return.

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### Connecticut

#### Conn. Gen. Stat. § 12-218(g) *Sourcing*

- (1) Any company that is (A) a limited partner in a partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) not otherwise carrying on or doing business in this state shall pay the tax imposed under section 12-214 solely on its distributive share as a partner of the income or loss of such partnership to the extent such income or loss is derived from or connected with sources within this state, except that, if the commissioner determines that the company and the partnership are, in substance, parts of a unitary business engaged in a single business enterprise or if the company is a member of a combined group that files a combined unitary tax return, the company shall be taxed in accordance with the provisions of subdivision (3) of this subsection and not in accordance with the provisions of this subdivision, provided, in lieu of the payment of tax based solely on its distributive share, such company may elect for any particular income year, on or before the due date or, if applicable

the extended due date, of its corporation business tax return for such income year, to apportion its net income within and without the state under the provisions of this chapter.

- (2) Any company that is (A) a limited partner (i) in an investment partnership or (ii) in a limited partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) otherwise carrying on or doing business in this state shall apportion its net income, including its distributive share as a partner of such partnership income or loss, within and without the state under the provisions of this chapter, except that the numerator and the denominator of its apportionment fraction shall include its proportionate part, as a partner, of the numerator and the denominator of such partnership's apportionment fraction. For purposes of this section, such partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment fraction as if it were a company taxable both within and without this state.
- (3) Any company that is a general partner in a partnership that does business, owns or leases property or maintains an office within this state shall, whether or not it is otherwise carrying on or doing business in this state, apportion its net income, including its distributive share as a partner of such partnership income or loss, within and without the state under the provisions of this chapter, except that the numerator and the denominator of its apportionment fraction shall include its proportionate part, as a partner, of the numerator and the denominator of such partnership's apportionment fraction. For purposes of this section, such partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment fraction as if it were a company taxable both within and without this state.

Conn. Gen. Stat. § 12-219a *Sourcing*

(b)(1) Any company that is (A) a limited partner in a partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) not otherwise carrying on or doing business in this state shall apportion the average value of its partnership interest within and without this state under the provisions of subsection (a) of this section, except that the numerator and the denominator of its apportionment fraction shall be its proportionate part of the partnership's apportionment factors. For purposes of this section, the partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment factors as if it were a company taxable both within and without this state. However, if the commissioner determines that the company and the partnership are, in substance, parts of a unitary business engaged in a single business enterprise, or, if the company is a member of a combined group that files a combined unitary tax return, the company shall be taxed in accordance with the provisions of subdivision (3) of this subsection and not in accordance with the provisions of this subdivision.

(b)(2) Any company that is (A) a limited partner (i) in an investment partnership or (ii) in a limited partnership, other than an investment partnership, that does business, owns or leases property or maintains an office within this state and (B) otherwise carrying on or doing business in this state shall apportion its additional tax base, including the average value of its partnership interest, within and without the state under the provisions of subsection (a) of this section, except that the numerator and the denominator of its apportionment factors shall include its proportionate part of the numerator and the denominator of the partnership's apportionment factors. For purposes of this section, the partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment factors, as if it were a company taxable both within and without this state.

(b)(3) Any company that is a general partner in a partnership that does business, owns or leases property or maintains an office within this state shall, whether or not it is otherwise carrying on or doing business in this state, apportion its additional tax base, including the average value of its partnership interest, within and without the state under the provisions of subsection (a) of this section, except that the numerator and the denominator of its apportionment factors shall include its proportionate part of the numerator and the denominator of the partnership's apportionment factors. For purposes of this section, the partnership shall compute its apportionment fraction and the numerator and the denominator of its apportionment factors, as if it were a company taxable both within and without this state.

(d) The additional tax base of taxable and nontaxable members of a combined group required to file a combined unitary tax return pursuant to section 12-222 shall be apportioned as provided in subsection (g) of section 12-218e.

Conn. Gen. Stat. § 12-213(a)(32) *Sourcing*

(32) "Unitary business" means a single economic enterprise that is made up either of separate parts of a single business entity or of a group of business entities under common ownership, which enterprise is sufficiently interdependent, integrated or interrelated through its activities so as to provide mutual benefit and produce a significant sharing or exchange of value among such entities, or a significant flow of value among the separate parts. For purposes of this chapter, (A) any business conducted by a pass-through entity shall be treated as conducted by its members, whether directly held or indirectly held through a series of pass-through entities, to the extent of the member's distributive share of the pass-through entity's income, regardless of the percentage of the member's ownership interest or its distributive or any other share of pass-through entity income, and (B) any business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a pass-through entity if there is a mutual benefit and a significant sharing of exchange or flow of value between the two parts of the business and the two corporations are members of the same group of business entities under common ownership

Conn. Gen. Stat. § 12-699 *PTE*

(d) If an affected business entity, the lower-tier entity, is a member of another affected business entity, the upper-tier entity, the lower-tier entity shall, when calculating its Connecticut source income, subtract its distributive share of income or add its distributive share of loss from the upper-tier entity to the extent that the income or loss was derived from or connected with sources within this state.

(e) Each affected business entity shall report to each of its members, for each taxable year, such member's direct share of the tax imposed under this section on such affected business entity and indirect share of the tax imposed on any upper-tier entity of which such affected business entity is a member.

Connecticut DOR Website Materials on PTE Tax *PTE*

Parent pass-through entity (parent PE) is a PE which is a member of another PE. A PE may be both a parent PE (with respect to one or more PEs) and a subsidiary PE (with respect to one or more PEs).

Subsidiary pass-through entity (subsidiary PE) is a PE which has at least one member which is itself a PE. A PE may be both a subsidiary PE (with respect to one or more PEs) and a parent PE (with respect to one or more PEs).

If the member is a PE, it is referred to as a parent PE and the PE of which it is a member is referred to as a subsidiary PE. The subsidiary PE must furnish a Schedule CT K-1 to the parent PE and report:

- Connecticut modifications that the parent PE must include on its Form CT-1065/CT-1120SI, Part 1, Schedule C, Columns A and B and Part 5;
- Amounts of the subsidiary PE's income or loss derived from or connected with Connecticut sources that the parent PE must include on its Form CT-1065/CT-1120SI, Part 1, Schedule D, Column B and Part 4, Column B;
- Amounts of PE Tax Credits allocated by the subsidiary PE to the parent PE that the parent PE should report on its Form CT-1065/CT-1120SI, Part 1, Schedule D, Column C and should allocate to its members on Part 9, Column C; and
- Amounts of tax credits that the parent PE must include on Form CT-1065/CT-1120SI, Part 7

The parent PE must, in turn, provide its members with:

- A Schedule CT K-1 reporting their share of the Connecticut modifications as reported on the parent PE's Form CT-1065/CT-1120SI, Part 5;
- Their share of the amounts of the income or loss derived from or connected with Connecticut sources as reported on the parent PE's Form CT-1065/CT-1120SI, Part 6;
- Their share of the PE Tax Credit reported on the parent PE's Form CT-1065/CT-1120SI, Part 9; and
- Their share of the income tax credits as reported on the parent PE's Form CT-1065/CT-1120SI, Part 7.

Conn. Form Instructions Form CT-1065/CT-1120SI *PTE*

Under the Standard Base, the PE is subject to tax on:

- All of its Connecticut source income (less any source income from subsidiary PEs).

Under the Alternative Base, the PE is subject to tax on:

- The portion of its Connecticut source income (less any Connecticut source income from subsidiary PEs) that directly or indirectly flows through to members who are resident individuals (RI), nonresident individuals (NI), resident trusts (RT), nonresident trusts (NT), resident estates (RE) or nonresident estates (NE). If a member is a PE (parent PE), the subsidiary PE may look through to the members of parent PE to determine what portion of subsidiary PE's Connecticut source income is subject to tax.

PLUS

- The portion of its total income that is not sourced to any state with which the PE has nexus (unsourced income) and that directly flows through to members who are resident individuals (RI). If a member is a parent PE, do not look through to the members of the parent PE to determine the portion of the unsourced income that is subject to tax. Form CT-1065/CT-1120SI Instructions (Rev. 12/22) The Standard Base is the default method and must be used unless the PE elects to file using the Alternative Base. To make the Alternative Base Election, the PE must check the "Alternative Base" box on Form CT-1065/CT-1120SI and must file the return, along with Schedule CT-AB, on or before the due date or extended due date, if applicable. No other filing is required to make the Alternative Base Election. The decision whether to file using the Standard Base or Alternative Base is made annually and is irrevocable.

Conn. Gen. Stat. § 12-719(b)(2)(D) *Withholding/Return*

If a member of a pass-through entity, referred to in this subparagraph as an "upper-tier pass-through entity", is itself a pass-through entity, the member, referred to in this subparagraph as a "lower-tier pass-through entity", shall be subject to the same requirements to make payment, on behalf of its members, of the income tax imposed on those members pursuant to this chapter that apply to the upper-tier pass-through entity under this subdivision. The department shall apply the income tax paid by the upper-tier pass-through entity, on behalf of the lower-tier pass-through entity, to the income tax required to be paid by the lower-tier pass-through entity, on behalf of its members. For purposes of this subdivision, "pass-through entity" means an S corporation, general partnership, limited partnership, limited liability partnership or limited liability company that is treated as a partnership for federal income tax purposes; and "member" means a shareholder of an S corporation, a partner in a general partnership, a limited partnership, or a limited liability partnership and a member of a limited liability company that is treated as a partnership for federal income tax purposes.

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## Delaware

### Del. Code Ann. tit. 30, § 1622 *Sourcing*

Each item of the income, gain, loss or deduction of a pass-through entity shall have the same character for a member of such pass-through entity under this title as it has for federal income tax purposes. Where federal income tax rules and principles are not determinative of the character or of the source of an item of income, gain, loss or deduction for purposes of this title, such item shall have the same character or source for a member of the pass-through entity as if the item were realized directly by such member from the source from which realized by the pass-through entity or incurred in the same manner as incurred by the pass-through entity. A member's distributive share of any item of the income, gain, loss or deduction of a pass-through entity shall, solely for purposes of the immediately preceding sentence, be determined by application of the principles of § 704(b) of the Internal Revenue Code [26 U.S.C. § 704(b)], including, without limitation, the principles for determining whether an allocation of such item among the members of such pass-through entity has substantial economic effect.

### Del. Code Ann. tit. 30, § 1623 *Sourcing*

(c) Corporate members of pass-through entities. — A corporation that is a member of a pass-through entity doing business or having real or tangible personal property in this State shall be subject to the provisions of Chapter 19 of this title; provided, however, that this subsection shall not be interpreted as precluding a corporation that is a member of a pass-through entity from qualifying for exemption from taxation under Chapter 19 pursuant to § 1902(b)(8) of this title.

(d) Allocation and apportionment of income. — In determining the tax liability under Chapter 19 of this title of a corporation that is a member of a pass-through entity doing business or having real or tangible personal property in this State:

Such corporation's federal taxable income shall be increased or decreased, as the case may be, by its distributive share of such pass-through entity's items, if any, described in § 1903(a) of this title;

Such corporation's distributive share of any item of such pass-through entity that is described in any of § 1903(b)(1) through (5) of this title shall be included in the entire net income of such corporation only if such item is properly allocable to this State under such § 1903(b) of this title; and

In applying § 1903(b)(6) of this title to such corporation,

(1) The entire business of such corporation shall not be treated as having been transacted or conducted within this State if any part of the business of such pass-through entity was transacted or conducted outside this State; and

(2) The 3 ratios described in such § 1903(b)(6) of this title of such corporation shall be determined by including in each such ratio such corporation's distributive share of each relevant item of such pass-through entity.

In applying § 1903(b)(7) of this title to such corporation, the ratio described in such § 1903(b)(7) of this title of such corporation shall be determined by including in such ratio the corporation's distributive share of each relevant item of such pass-through entity.

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## District of Columbia

### D.C. Code § 47-1801.4(55)(B) *Sourcing*

For the purposes of this chapter, any business conducted by a partnership within the meaning of § 47-1808.06 shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the percentage of the partner's ownership interest or its distributive or any other share of partnership income. A business conducted directly or indirectly by one person is unitary with that portion of a business conducted by another person through its direct or indirect interest in a partnership if there is a synergy and exchange and flow of value between the 2 parts of the business and the 2 persons are members of the same commonly controlled group.

### D.C. Code § 47-1810.02 *Sourcing*

Allocation and apportionment. - The entire net income of any corporation, financial institution, or unincorporated business, or the unrelated business income of an exempt organization, derived from any trade or business carried on or engaged wholly within the District shall, for the purposes of this chapter, be deemed to be from sources within the District and shall, along with other income from sources within the District, be allocated to the District. If the net income of a corporation, financial institution, or unincorporated business, or the unrelated business income of an exempt organization, is derived from sources within and without the District, the taxpayer shall apportion business income and allocate non-business income as provided in this section.

### D.C. Code § 47-1810.04(c)(1)(B)(2) *Sourcing*

If any member owns an interest in a partnership that is not an unincorporated business, as defined by § 47-1808.01, the income or loss of such partnership shall be apportioned to the District using the apportionment factor of the partnership, and the combined group member-partner's distributive share of such income shall be added to the combined group member-partner's income."

### D.C. Mun. Regs. tit. 9, § 109.20(h) *Sourcing*

The amounts of the property, payroll, and sales of a partnership are attributable to the partners or members of the joint venture. A corporation that is a partner in a partnership must add its share of the property, payroll, and sales to its own apportionment factors, regardless of whether the partnerships are District of Columbia partnerships. The affiliated group should include a separate schedule to show the distribution to each partner.

### Agency Website *Sourcing*

If a partner is a combined group member, the partner must include or exclude its distributive share of income or loss in the following manner:

(a) Starting point for a partner: A partner on the D-20 or D-30 generally starts with federal income and deduction items which are modified for District purposes. In this income, the distributive share of partnership interest should already have been included and modified for District tax purposes on the "Other income (loss)" line (currently line 9, on D-20 or D-30).

(b) Exclusion modification: If the distributive share has been reported by and taxed against any person, the partner's distributive share of this income or loss shall be excluded from the partner's return on line 9 of the D-20 or D-30 to prevent double taxation or double deduction (see also UB Worksheet A and B). The amount that should be excluded is that which has been apportioned to and taxed within the District and that portion which has been subject to apportionment and taxed outside the District.

(c) Treatment of distributive loss: If the distributive share of a partner is a loss and the entity which issued the distributive share is also filing a District return (stand-alone or combined), and the entity is carrying forward that loss to future years, the distributive share of that loss is not allowed on the partner's return to avoid double deduction of the loss because this loss is a loss of the entity and not of the partner.

(d) No flow through of factors: A partner shall not flow through its share of the UB or partnership's apportionment factors and combine them with its own factors. However, a single member entity, if disregarded for federal income tax purposes, shall be treated as disregarded for District income and franchise tax purposes, and all the income, deductions, and apportionment factors shall be included with and reported by the owner of the single member entity.

(e) Apportionment of partner's distributive share of UB or partnership: If the UB or partnership is both within and without the District, then any portion of the partner's distributive share from the K-1 (modified for District tax purposes) which has not been reported and taxed at the UB level on the combined report shall be included in the partner's income and apportioned, if it is business income.

(f) To calculate the apportionment factor to apply to the untaxed income as indicated in (e):

(1) Denominator. The denominator shall be the total net unreported and untaxed distributive share of the income which shall be added to the partner's sales factor.

(2) Numerator. The numerator shall be the unreported and untaxed portion of the distributive share multiplied by the UB's or partnership's apportionment percentage.

(3) Example: If the distributive share is \$200 and \$100 of that share was reported and taxed at the UB level, and the remaining \$100 (the net amount) was untaxed, that \$100 will be added to the partner's sales factor denominator. If the UB's apportionment factor is 50%, then \$50 will be added to the partner's sales factor numerator for purposes of apportioning the part which was not previously apportioned and taxed

(g) UB filing requirements: If a UB is a member of the combined group, the UB shall report all its income and apportionment factors on the combined report only and not file a stand-alone return.

## Florida

### Fla. Admin. Code Ann. r. 12C-1.015(10) *Sourcing*

Partnerships. The amounts of the property, payroll, and sales of a partnership are attributable to the partners or members of the joint venture. A corporation that is a partner in a partnership must add its share of the property, payroll, and sales to its own apportionment factors, regardless of whether the partnerships are Florida partnerships. Form F-1065 is used in part to distribute to each partner subject to the tax its share of the apportionment factors of the partnership or joint venture.

### Florida TAA # 11C1-001(February 2, 2011) *Sourcing*

Whether the taxpayer's sales, payroll, and property factors of the apportionment formula should include the taxpayer's interest in various partnerships . . .

The Florida statutes and rules are clear that the activities of a partnership flow through the partnership to its partners. In its letter dated XXX, the taxpayer states that the partnerships it invests in contain multiple layers of ownership, and the lower tiered and middle tiered partnerships do not report apportionment information to the top tiered partnership because they are not required to do so in the states where they are located. Therefore, the upper tiered partnerships do not have any way to report the apportionment information from the middle and lower tiered partnerships to the corporate partner (in this case the taxpayer).

For federal income tax purposes, partnerships generally have no formal federal filing requirement other than information returns, and because a partnership is a conduit, items of partnership income, expense, gain, or loss pass through to the partners and are given tax effect at the partner level. For state income tax apportionment purposes, a particular state's approach in this area dictates the flow-through of partnership tax attributes up to the corporate partner.

Florida's approach conforms to the federal concept of the flow-through of partnership tax attributes up to the corporate partner. The apportionment rule, Rule 12C-1.015(10), F.A.C., governs the corporate income tax treatment of corporations that invest in partnerships. This rule provides that a corporation that is a partner in a partnership must add its share of the partnership's property, payroll, and sales to its own apportionment factor. Based on the foregoing, the partnerships' property, payroll, and sales should be combined with the taxpayer's property, payroll, and sales, for purposes of determining the taxpayer's apportionment factor as provided by Rule 12C-1.0153(9), F.A.C., Rule 12C-1.0154(6), F.A.C., and Rule 12C-1.0155(4), F.A.C.

The taxpayer asserts that the tiered partnerships do not provide the taxpayer with their respective apportionment factors. Therefore, the taxpayer does not have the required apportionment information to correctly apportion its income in accordance with Rule 12C-1.015(10), F.A.C. However, the Florida statutes and rules are clear that the activities of a partnership flow through the partnership to its partners. Therefore, the activities of the partnership are attributable to the partners and, contrary to the statement in the taxpayer's letter, are unitary to the partners.

### Florida TAA # 23C1-012 (October 3, 2023) *Sourcing*

In the case of a flow-through entity (i.e., whose income flows through to Taxpayer, Taxpayer's portion of the sales factor provided to it by \_\_\_ for inclusion in Taxpayer's own factors should reflect the proper sourcing of the \_\_\_ based on the location of \_\_\_ customers.

### Florida Form F-1065: Partnership Information Return Instructions (2022) *Sourcing*



Each partner's share of the apportionment factors is determined by multiplying the amount in Part III-A, on Lines 1, 2, and 3 by the percentage interest of each partner. Amounts determined should be added to each partner's apportionment factors included on its Florida Form F-1120. Partnerships subject to a special industry apportionment fraction (for example, those engaged mainly in transportation services) should adjust this schedule to report each partner's share of the special apportionment fraction (for example, revenue miles for transportation

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## Georgia

### Ga. Comp. R. & Regs. § 560-7-7-.03(4)(e) and 5(f) *Sourcing*

A corporation that is involved in a business joint venture, is a member of a limited liability company or similar nontaxable entity not treated as a corporation for federal income tax purposes, or is a partner in a business partnership, must include its pro rata share of the entity's property, payroll, and gross receipts in its own apportionment formula. In determining its income, the corporation includes its share of the entity's income before the entity apportions and allocates its income.

### Ga. Code Ann. § 48-7-53(c)(3)(C) *Sourcing* (in audit situation)

Determine the total distributive share of all final federal adjustments and positive reallocation adjustments as modified by this title and apportion and allocate such adjustments as provided in Code Section 48-7-31 for such electing partnership or such electing tiered partner and determine the total distributive share of such amounts that are allocated to all corporate partners, all tiered partners, all exempt partners and that is unrelated business income, all nonresident individual partners, and all nonresident fiduciary partners. If the commissioner determines that a partnership or tiered partner fraudulently underreported its income on a return, the commissioner shall treat any income attributable to a tiered partner of such partnership or tiered partner as being apportioned and allocated entirely to Georgia to the extent the direct and indirect partners of such tiered partner are resident partners.

### Ga. Comp. R. & Regs. 560-7-8-.34 *Withholding/Return*

(4) Tiered Situations. Except as provided in paragraph (5), in situations whereby the nonresident member is an entity, or where such nonresident member is owned by subsequent entities, the following shall apply:

(a) Withholding is only required by an entity that:

1. Does business in Georgia on its own and not as a result of being a member; or
2. Owns property in Georgia on its own and not as a result of being a member;

(b) Any withholding that occurs may be passed through each tier by attaching the G-2-A, of the entity in the tiered situation that was required to withhold pursuant to subparagraph (4)(a), and providing a schedule which allocates such withholding tax between the members at each tier based upon the profit/loss percentage. Failure to include this documentation will result in the disallowance of the withholding credit. A composite return may be completed at any level. However, if the composite return is not filed by the entity meeting either condition 1. or 2. of subparagraph (a) of this paragraph, withholding is still required by such entity, unless otherwise exempted by this regulation or O.C.G.A. § 48-7-129. Tax withheld at one level can be claimed on a composite return at another level.

(c) A member which is an entity or a corporation must include its pro rata share of the entity's gross receipts in its own single factor apportionment formula in determining how much of its income is Georgia income. In determining its income, the member includes its share of the entity's income before the entity apportions and allocates its income.

(d) In determining whether withholding is required, only the members that directly own an interest in the entity subject to withholding shall be considered.

For example:

1. An entity that is subject to the nonresident withholding requirements has several members. One nonresident member is also a member in several other entities that are subject to the withholding requirements. Each of the entities must withhold on that nonresident member whether or not the total income/loss from all the entities would result in a net loss for that member. A loss from one entity cannot be used to offset the income in another entity for that member.

2. Company A is subject to the nonresident withholding requirements and is in a tiered situation. Company B is a nonresident member of Company A. Company B has nonresident members, of which one is an exempt organization called Company C. Company A is required to withhold on all of Company B's share of taxable income sourced to this state.

(5) Exception in Tiered Situations.

(a) Nonresident withholding shall not be required for a member which is also an entity provided such entity on an annual basis in writing:

1. Elects to withhold at the rate of 4 percent with respect to its nonresident members' shares of taxable income sourced to this state in the same manner and subject to the same requirements, exceptions (including the exception provided in this paragraph but excluding the exception provided in subparagraph (2)(c)), etc. as if such entity itself was subject to O.C.G.A. § 48-7-129 and this regulation;

2. Agrees to be subject to personal jurisdiction in this State for all income tax purposes including the withholding required by O.C.G.A. § 48-7-129, together with related interest and penalties; and

3. Provides such election and such agreement in writing to the entity in which it is a member, using Form NRW-Exemption, on or before the due date (without extension) for filing the entity's income tax return for the taxable year for which the withholding is required. Form NRW-Exemption must be attached to the entity's income tax return each year.

(b) In the event such entity makes the election as provided in subparagraph (a)1. of this paragraph and such entity does not withhold at the rate of 4% if required to do so, then such exception shall not apply and withholding will be due as originally required as if such election had not been made.

(c) Each entity in subsequent tiers shall be entitled to make such election and such agreement provided the entity in which it is a member makes such election. However, failure by any entity in any tier to withhold at the rate of 4% if required to do so shall cause withholding to be due as originally required and as if such elections were not made by any entity in any tier.

## Hawaii

### Haw. Code R. § 18-235-29-04 *Sourcing*

(a) If a taxpayer is a partner in a partnership, and the partnership's activities and the taxpayer's activities constitute a unitary business:

(1) The taxpayer's share of the partnership's trade or business shall be combined with the taxpayer's trade or business;

(2) The property, payroll, and sales factors, or other applicable factors, of the taxpayer and the partnership shall be combined; and

(3) Intercompany items shall be eliminated, under the principles set forth in section 18-235-22-03.

Example 1: Corporation A's distributive share of income in partnership P is 20 per cent. Corporation A manufactures toys which are sold in the seven western states by partnership P. Corporation A's business income for the year was \$1,000,000 and partnership P's business income for the same year was \$800,000. The business income of corporation A is \$1,160,000 (\$1,000,000 plus 20 per cent of \$800,000).

Example 2: The facts are the same as in Example 1. Partnership P owns a building with an original cost of \$100,000 which is rented to corporation A for \$12,000 per year. Corporation A shall include \$20,000 (20 per cent of \$100,000) in its property factor because of its interest in partnership P. In addition, Corporation A shall take into account \$9,600 (\$12,000 less 20 per cent of \$12,000) of rental expense into its property factor in order to include in the property factor the rented building used in Corporation A's operation. Thus, Corporation A shall include \$76,800 (\$9,600 multiplied by 8, pursuant to section 235-31, HRS) for the rent paid, and \$20,000 for its interest in the building through Partnership P, in its property factor, totalling \$96,800 attributable to the building.

(b) If a taxpayer is a partner in a partnership, and the partnership's activities and the taxpayer's activities do not constitute a unitary business, the partnership shall allocate and apportion its income at the partnership level. The taxpayer's distributive share of the partnership's income allocated or apportioned to this State shall not be subject to further apportionment by the taxpayer.

Example: Corporation A's distributive share of income in partnership P is 20 per cent. Corporation A manufactures and sells toys in the seven western states. Partnership P operates farms within and without this State. Both corporation A and partnership P earn exclusively business income, except for distributions from Partnership P. Corporation A's business income for the year is \$1,000,000 and partnership P's income is \$800,000 for the same year. Because corporation A and partnership P are engaged in two different trades or businesses, corporation A shall apportion its \$1,000,000 income on the basis of its own apportionment formula. Partnership P shall apportion its business income of \$800,000 on the basis of its own apportionment formula. Corporation A's apportionment factors are determined without regard to Partnership P's apportionment factors, and vice versa. Assume that corporation A's apportionment percentage determined under section 18-235-29-01 is 35 per cent, and that partnership P's apportionment percentage is 10 per cent. Partnership P's Hawaii income is 10 per cent of the income from its farming business (\$80,000 = 10 per cent × \$800,000). Corporation A is taxable in this State upon 35 per cent of the income from its toy manufacturing business (\$350,000 = 35 per cent × \$1,000,000) plus its full distributive share of the partnership income attributed to this State (\$16,000 = 20 per cent × \$80,000), or \$366,000.

If an Electing PTE has a member that is also a PTE, the Upper-Tier PTE (i.e., the member) is not required to elect PTE taxation to pass the PTE credit received from the Lower-Tier PTE (i.e., the Electing PTE) to its members. The Upper-Tier PTE must, however, file a schedule, in the form prescribed by the Department, identifying the Lower-Tier PTE, the amount of PTE credit passed from the Lower-Tier PTE, and each of the Upper-Tier PTE's member's share of the PTE credit.

Example: PTE1, a pass-through entity whose members include Individual A, PTE2, and PTE3, makes an election for pass-through entity taxation, timely files the required schedule, and timely pays the pass-through entity tax. PTE2, a passthrough entity whose members include Individual B and Individual C, does not elect pass-through entity taxation and does not file a schedule detailing each member's share of the pass-through entity tax paid. PTE3, a pass-through entity whose members include Individual D and Individual E, does not elect passthrough entity taxation, but timely files a schedule detailing each member's share of the pass-through entity tax paid. Individual A may claim a credit for pass-through entity taxes paid by PTE1. Individual B and Individual C may not claim a credit for pass-through entity taxes paid by PTE1 because PTE2 did not file the required schedule. Individual D and Individual E may claim a credit for pass-through entity taxes paid by PTE1 because PTE3 filed the required schedule.

If an Electing PTE has a member that is also a PTE, and the member also makes an election for PTE taxation, Act 50 does not permit the Upper-Tier PTE, in determining the amount of PTE tax due, to exclude income from the Lower-Tier PTE.

#### Hawaii Instructions for Form N-20 (2022) *Withholding/Return*

If a partner has other income from Hawaii sources such as multiple partnerships, even though the partnerships are related, a separate net income tax return must be filed by that partner.

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## Idaho

### Idaho Admin. Code r. 35.01.01.620 *Sourcing*

01. In General. If a corporation required to file an Idaho income tax return is a member of an operating partnership, the corporation is to report its Idaho taxable income, including its share of income from the partnership, in accordance with this rule. For purposes of this rule, the term partnership includes a joint venture.

02. Transacting Business. A corporation is transacting business in Idaho if it is a partner in a partnership that is transacting business in Idaho even though the corporation has no other contact with Idaho. In this case, both the partnership and the corporation have an Idaho filing requirement.

03. Multistate Partnerships. If a partnership operates in more than one state, its income is to be apportioned and allocated on the partnership return as if the partnership were a corporation. The allocation and apportionment rules of Section 63-3027, Idaho Code, and related rules apply to the partnership.

04. Partnership Income as Apportionable Income of the Partner.

a. Income. If the income or loss of a partnership is apportionable income or loss to a corporate partner, its share of this net apportionable income or loss is to be apportioned together with all other net apportionable income or loss of the corporation. Apportionable income or loss is defined by Section 63-3027(1)(a), Idaho Code, and Rules 330 through 336 of these rules.

b. Factors. A corporate partner's share of the partnership property, payroll, and sales after intercompany eliminations, is to be included in the numerators and the denominators of the partner's property, payroll, and sales factors when computing its apportionment formula. The partner's share of the partnership's property, payroll, and sales is determined by attributing the partnership's property, payroll, and sales to the partner in the same proportion as its distributive share of partnership income if reporting net income for the taxable year or in the same proportion as its distributive share of partnership losses if reporting a net loss for the taxable year. Generally, the partnership's property, payroll, and sales includable in the corporation's factor computations is determined in accordance with Section 63-3027, Idaho Code, and related rules. To determine how the sales attribution rules of Sections 63-3027(12) and (13), Idaho Code, apply to the sales factor of the corporate partner, the sales of the partnership are treated as if they were sales of the corporation.

#### 05. Partnership Income as Nonapportionable Income of Partner.

a. Income. If the partnership income or loss is not apportionable income to a corporate partner, the income is nonapportionable income as defined in Section 63-3027(1)(h), Idaho Code, and Rules 335 through 339 of these rules. The corporate partner is to allocate the nonapportionable income to the state in which it was earned. The corporate partner, on its Idaho corporation income tax return, is to specifically allocate to Idaho its share of the nonapportionable income attributable to Idaho.

b. Factors. If the partnership income or loss is nonapportionable income to the corporate partner, none of the partnership property, payroll, or sales may be included in the computation of the factors of the corporation.

#### Idaho Code § 63-3026B PTE

(9) Each affected business entity that is a member of another affected business entity and elects to be subject to the tax imposed under this section is entitled to a credit against such tax. The credit will be in an amount equal to the affected business entity's pro rata share of the tax paid under this section by any affected business entity of which the affected business entity is a member. Such credit will be applied after all other applicable credits have been applied. Any balance of the credit not used in the taxable year during which the affected business entity reports net income will be paid as a refund to the affected business entity. Such pro rata share of the tax credit shall be calculated by excluding the share of any member that is an exempt entity.

(10) Each pass-through entity, as defined in section 63-3006C, Idaho Code, that is a member of an affected business entity and does not elect to be subject to the tax imposed under this section is entitled to a credit. The credit will be in an amount equal to the pass-through entity's pro rata share of the tax paid under this section by any affected business entity of which the pass-through entity is a member. Such credit will be applied after all other applicable taxes and credits have been applied. Any balance of the credit not used in the taxable year will be paid as a refund to the pass-through entity.

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## Illinois

### 35 Ill. Comp. Stat. 5/305 Sourcing

(a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with

their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

(b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

(c) Allocation or apportionment of base income by partnership. Base income of a partnership shall be allocated or apportioned to this State pursuant to Article 3, in the same manner as it is allocated or apportioned for any other nonresident . . .

### Ill. Admin. Code tit. 86, § 100.3500(d) *Sourcing*

#### Allocation and Apportionment of Base Income by Nonresident Partners

##### a) In General.

1) This Section provides guidance for allocation and apportionment of base income by nonresidents. All base income of a resident is allocated to Illinois pursuant to IITA Section 301(a) . . .

3) Unitary partners. This Section shall not apply to the apportionment of business income of a nonresident partner who is engaged in a unitary business with the partnership. Such partners shall apportion their unitary business income derived from the partnership in accordance with IITA Section 304(e) and Section 100.3380(d) of this Part.

4) Except as provided in this subsection (a), all items of base income of a partner that are derived from the partnership shall be allocated or apportioned pursuant to this Section, including all items required to be separately stated to the partner under IRC section 703(a)(1), all guaranteed payments under IRC section 707(c), and all addition and subtraction modifications, but excluding items described in IRC section 707(a).

b) Business Income. The respective shares of partners other than residents in so much of the business income of the partnership as is apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State. (IITA Section 305(a))

1) For purposes of this subsection (b), the determination of whether an item of base income is business income or nonbusiness income shall be based on the facts and circumstances of the partnership itself. Trade or business activities of a partner or of any related party are irrelevant.

2) Business income of the partnership shall be apportioned to this State pursuant to IITA Section 304, in the same manner as it is allocated or apportioned for any other nonresident. (IITA Section 305(c))

3) Lower-tier partnerships. In the case of a partnership that is itself a partner in a second partnership, a partner in the first partnership shall include in net income its partnership share of the first partnership's share of the items of business income of the second partnership, as apportioned to Illinois by that second partnership. If the second partnership is itself a partner in a third partnership, a partner in the first partnership

shall include in net income its partnership share of the first partnership's share of the items of business income of the third partnership as determined under the preceding sentence, and so on through all partnerships that are themselves partners in other partnerships.

c) Nonbusiness Income. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities. (IITA Section 305(b))

### III. Admin. Code tit. 86, § 100.3380(d) *Sourcing*

#### Unitary Partners: Inclusion of Shares of Partnership Unitary Business Income and Factors in Combined Unitary Business Income and Factors of Partners

1) IITA Section 304(e) provides that whenever 2 or more persons are engaged in a unitary business as described in IITA Section 1501(a)(27), a part of which is conducted in this State by one or more members of the group, the business income attributable to this State by any member or members shall be apportioned by means of the combined apportionment method. Because partnerships may be members of a unitary business group within the meaning of IITA Section 1501(a)(27), this provision requires a partnership to use combined apportionment when it is engaged in a unitary business with one or more of its partners. However, partners who are not engaged in a unitary business with the partnership shall include their shares of the partnership's business income apportioned to Illinois in their Illinois net incomes under IITA Section 305(a), and those partners' business activities or share of the partnership's market in Illinois would not be represented fairly by their shares of partnership income computed by combining the business income and apportionment factors of the partnership with the business income and apportionment factors of its unitary partners.

2) Accordingly, except in a case in which substantially all of the interests in the partnership (other than a publicly-traded partnership under IRC section 7704) are owned or controlled by members of the same unitary business group, when the business activities of a partnership and any of its partners' business activities constitute a unitary business:

A) The partner's distributive share of the business income and apportionment factors of the partnership shall be included in that partner's business income and apportionment factors. Also, for taxable years ending on or after December 31, 2017, the partner's distributive share of the everywhere sales of the partnership shall be included in the partner's everywhere sales for purposes of applying Section 100.3600. In determining the business income of the partnership, transactions between the unitary partner (or members of its unitary business group) and the partnership shall not be eliminated. However, all transactions between the unitary business group and the partnership shall be eliminated for purposes of computing the apportionment factors of the partner and of any other member of the unitary business group.

EXAMPLE: Partner and Partnership are engaged in a unitary business. Partner owns a 20% interest in Partnership. Partnership has \$10,000,000 in sales everywhere, \$3,000,000 of which are to Partner, and \$4,000,000 in Illinois sales, \$1,000,000 of which are to Partner. In computing its apportionment factor, Partner shall include \$1,400,000 from Partnership in its everywhere sales (20% of Partnership's \$10,000,000 in everywhere sales, after eliminating the \$3,000,000 in sales to Partner) and \$600,000 from Partnership in its Illinois sales (20% of Partnership's \$4,000,000 in Illinois sales, after eliminating the \$1,000,000 in sales to Partner). Also, Partner must eliminate any sales it made to Partnership.

B) If a partnership and one of its partners are engaged in a unitary business and the partnership is itself a partner in a second partnership:

i) If the partner is not engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall not be included in the partner's business income and apportionment factors. Instead, the partner's share of the first partnership's share of the base income apportioned to Illinois by the second partnership shall be included in the partner's Illinois net income.

ii) If the partner is engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall be included in the partner's business income and apportionment factors.

C) If, for taxable years ending on or after December 31, 2017, a partner and a partnership engaged in a unitary business apportion their business income using different apportionment formulas under IITA Section 304:

i) The apportionment percentage of the partnership shall be computed under Section 100.3600 by treating the partnership as a member of the unitary business group, but using only that partner's distributive share of the partnership's apportionment factors and sales. That partner's apportionment percentage is equal to that partner's apportionment percentage computed under Section 100.3600 plus the partnership's apportionment percentage computed under Section 100.3600.

ii) If a partnership has more than one partner in the same unitary business group, and the partnership uses a different apportionment formula than one or more of the partners, each partner that uses the same apportionment formula as the partnership shall compute its apportionment factor as provided in subsection (d)(2)(A) and each partner that uses a different apportionment formula shall compute its apportionment factor as provided in subsection (d)(2)(C)(i).

3) This subsection (d) does not apply to a partner's shares of business income and apportionment factors from any partnership that cannot be included in a unitary business group with that partner.

A) This subsection (d) does not apply because:

i) for taxable years ending prior to December 31, 2017, the partner and the partnership are required to apportion their business income using different apportionment formulas under IITA Section 304, and therefore cannot be members of a unitary business group under IITA Section 1501(a)(27); or

ii) the business activities of either the partner or the partnership outside the United States are equal to or greater than 80% of the total worldwide business activities of that partner or partnership, as determined under IITA Section 1502(a)(27). In applying this 80/20 test to a taxpayer, no apportionment factors of any partnership shall be included in the apportionment factors of that taxpayer pursuant to this subsection (d).

B) For taxable years ending prior to December 31, 2017, if the partnership is itself a partner in a second partnership, and one of its partners is engaged in a unitary business with the second partnership and is not prohibited from being a member of a unitary business group that includes the second partnership under subsection (d)(3)(A)(i) or (ii), that partner shall include in its business income and apportionment factors its share of the partnership's share of the second partnership's business income and apportionment factors.



4) If substantially all of the interests in a partnership (other than a publicly-traded partnership under IRC section 7704) are owned or controlled by members of the same unitary business group as the partnership, the partnership shall be treated as a member of the unitary business group for all purposes, and, for purposes of applying IITA Section 305(a) to any nonresident partner who is not a member of the same unitary business group, the business income of the partnership apportioned to this State shall be determined using the combined apportionment method prescribed by IITA Section 304(e). For purposes of this subsection (d), substantially all of the interests in a partnership are owned or controlled by members of the same unitary business group if more than 90% of the federal taxable income of the partnership is allocable to one or more of the following persons:

A) any member of the unitary business group;

B) any person who would be a member of the unitary business group if not for the fact that 80% or more of that person's business activities are conducted outside the United States;

C) any person who would be a member of the unitary business group except for the fact that the person and the partnership apportion their business incomes under different subsections of IITA Section 304 and, therefore, for taxable years ending prior to December 31, 2017, would be excluded from a unitary business group in which the partnership is a member; or

D) any person who would be disallowed a deduction for losses by IRC section 267(b), (c) and (f)(1) by virtue of being related to any person described in subsection (d)(4)(A), (B) or (C), as well as any partnership in which a person described in subsection (d)(4)(A), (B) or (C) is a partner.

#### 5) Examples

EXAMPLE 1: Corporation A owns a 50% interest in P-1, a partnership. Corporation A and P-1 are engaged in a unitary business within the meaning of IITA Section 1501(a)(27). P-1 itself conducts no business activities in Illinois, and the Illinois numerator of its apportionment factor is zero. P-1 holds a 50% interest in P-2, a partnership doing business exclusively in Illinois. P-1 has \$1.4 million of taxable business income, not including any income from P-2. P-2 has base income of \$1 million, all of which is business income, and on a separate-entity basis, all of its business income would be apportioned to Illinois.

EXAMPLE 2: If Corporation A and P-2 are not members of the same unitary business group, Corporation A would compute its business income apportioned to Illinois by including \$700,000 (50% of \$1.4 million) of P-1's business income in Corporation A's business income, and 50% of P-1's apportionment factors in its apportionment factors. Corporation A also would include in its Illinois net income its 50% share of P-1's 50% share of the base of P-2 apportionable to Illinois, or \$250,000 (50% of 50% of \$1 million).

EXAMPLE 3: If Corporation A, P-1 and P-2 are members of the same unitary business group, P-1 shall include 50% of P-2's business income and 50% of P-2's apportionment factors in its own business income and apportionment factors. Accordingly, P-1's business income will be \$1.9 million (the \$1.4 million it earned directly plus its 50% share of P-2's \$1 million in business income). Corporation A will then compute its business income apportioned to Illinois by including its 50% share of P-1's business income, or \$950,000 (50% of \$1.9 million) with its business income and its 50% share of P-1's apportionment factors (which will include P-1's share of P-2's apportionment factors) in its apportionment factors.

EXAMPLE 4: If Corporation A, P-1 and P-2 are unitary, but P-1 is excluded from the unitary business group of Corporation A and P-2 because those entities apportion their business income under IITA Section 304(a) and P-1 is a financial organization that apportions its business income under IITA Section 304(c) and the taxable year ends prior to December 31, 2017, Corporation A shall include in its business income and apportionment factors its 50% share of P-1's 50% share of the business income and apportionment factors of P-2. Also, Corporation A's Illinois net income includes 50% of the business income of P-1 apportioned to Illinois by P-1 using its own apportionment factors. Because, in this example, P-1 is not doing business in Illinois, none of its business income is included in Corporation A's Illinois net income . . .

#### Illinois IL-1065 Instructions(2022) *Sourcing*

Partnerships may not join in the filing of a combined return. However, you may be required to file a separate unitary return, and file a Schedule UB, Combined Apportionment for Unitary Business Group, to apportion your business income. If the following applies, do not file a Schedule UB: If a partnership is engaged in a unitary business with one or more of its partners, but the unitary partners do not own substantially all of the interest in the partnership, the partnership should not be included on a Schedule UB with the partners. Substantial ownership is defined as owning more than 90 percent of all the interest in the partnership. If a Schedule UB should not be filed, each unitary partner must determine the portion of its business income taxed by Illinois by adding its share of that partnership's business income and apportionment factors (Illinois and everywhere) to its own business income and apportionment factors (Illinois and everywhere). This rule applies to you if you are unitary with one or more of your partners or if you are a partner in another partnership and are engaged in a unitary business with that partnership. See 86 Ill. Adm. Code Section 100.3380(d), for more information.

If the following applies, you must file a Schedule UB: If you are a partnership who is a shareholder in a corporation and are engaged in a unitary business with that corporation, or if you are owned more than 90 percent by members of your unitary business group (determined without regard to the rule prohibiting taxpayers who use different apportionment formulas from being included in a unitary business group and the rule prohibiting taxpayers conducting 80 percent or more of their business activities outside the United States from being included in a unitary business group), and you:

- use the same taxable year as a combined group that includes your partners or your subsidiary, you should use the Schedule UB prepared by the combined group in completing your Form IL-1065;
- use a different taxable year from the combined group that includes your partners or your subsidiary, or there is no combined group, you must complete your own Schedule UB using your own taxable year.

#### 35 Ill. Comp. Stat. 5/201(p)(3)(B) *PTE*

Special rule for tiered partnerships. If a taxpayer making the election under paragraph (1) is a partner of another taxpayer making the election under paragraph (1), net income shall be computed as provided in subparagraph (A), except that the taxpayer shall subtract its distributive share of the net income of the electing partnership (including its distributive share of the net income of the electing partnership derived as a distributive share from electing partnerships in which it is a partner).

#### Illinois Department of Revenue Website *PTE*

If a taxpayer making the PTE tax election is a partner of another taxpayer who made the PTE tax election, net income shall be computed as above, except that the taxpayer shall subtract its distributive share of the net income of the electing partnership

(including its distributive share of the net income of the electing partnership derived as a distributive share from electing partnerships in which it is a partner).

### Ill. Admin. Code tit. 86, § 7035(d)(1) *Withholding/Return*

If the owner is a pass-through entity, it may claim some or all of that amount as a credit against the amount it is required to withhold from its owners under this Section, in lieu of claiming the credit against its liability under IITA Section 201. (See IITA Section 709.5(b).) Once a return claiming an amount of credit against the owner's liability under this Section or under IITA Section 201 has been filed, the owner may not claim that amount as a credit against any other liability.

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## Indiana

### Ind. Code § 6-3-2-2(a) *Sourcing*

Income from a pass through entity shall be characterized in a manner consistent with the income's characterization for federal income tax purposes and shall be considered Indiana source income as if the person, corporation, or pass through entity that received the income had directly engaged in the income producing activity. Income that is derived from one (1) pass through entity and is considered to pass through to another pass through entity does not change these characteristics or attribution provisions. In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter), only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (s) is considered derived from sources within Indiana. Income derived from Indiana shall be taxable to the fullest extent permitted by the Constitution of the United States and federal law, regardless of whether the taxpayer has a physical presence in Indiana.

### 45 Ind. Admin. Code 3.1-1-106(b)(2) *Sourcing*

The distributive share of a nonresident partner will be reported after apportionment to determine the partnership income derived from sources within Indiana. This determination will be accomplished by use of the apportionment formula described in IC 6-3-2-2(b).

### 45 Ind. Admin. Code 3.1-1-153 *Sourcing*

(a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.

(b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate

partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year, with the following modifications:

(b)(1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.

(b)(2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:

(b)(2)(A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.

(b)(2)(B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.

(c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:

(c)(1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.

(c)(2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.

(d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

Indiana Letters of Findings: 02-20130024 (October 29, 2014) *Sourcing*

The Indiana Supreme Court discussed such a form-over-function situation in *Park 100 Dev. Co. v. Ind. Dep't of State Revenue*, 429 N.E.2d 220 (Ind. 1981). In *Park 100*, the Indiana Supreme Court was faced with a situation in which a partnership was itself a partner in a partnership and, on that ground sought to avoid Indiana taxes. *Id.* at 223. In other words, one pass-through entity was owned by another pass-through entity. The Indiana Supreme Court held that a partnership could not avoid its Indiana tax obligations by becoming a partner in a different partnership (essentially stacking partnerships to avoid tax) and funneling the business receipts through these pass-through entities. *Id.* at 223. Thus, using tiered pass-through entities to funnel income to another partner did not obviate the taxpayer's tax obligation. *Id.* The court reasoned that passing income through multiple layers of partnerships does not cancel the tax liability associated with the original partnership's income. *Id.* As the court explained, "[T]he

legislature did not intend for a corporation to escape the corporate tax liability indirectly by forming a two-tiered partnership when it did not allow a corporation to escape that liability as a direct or first-tier partner." Id.

Like the taxpayer in Riverboat Development, Inc., the taxpayers in Park 100 owned a minority ownership interest in the pass-through entity generating the taxable income. Nevertheless, the tax liability still passed through to the owners. Moreover, the court was not persuaded by the fact that the tax liability stemmed from the taxpayer's intangible interest in a partnership. The court's ultimate concern was avoiding the creation of law that would lead to untenable results, such as avoiding tax liabilities by funneling income through a partnership. At no point in the Park 100 decision did the court suggest that the character of the income, and resulting tax liability, was dependent upon whether the taxpayer's ownership interest in the partnership was tangible or intangible in nature. Nor was there any reason for the court to consider the tangible or intangible nature of the ownership, because the focus was the character of the business income earned by the pass-through entity.

Additionally, in *Five Star Concrete, L.L.C. v. Klink, Inc.* 693 N.E.2d 583 (Ind. Ct. App. 1998), the Indiana Court of Appeals explained that LLCs are like partnerships, and like partnerships the "income 'passes through' the entity and is taxed to the member, an owner of an interest in the company." Id. at 586. The court was very specific—LLCs, like partnerships, pass-through income to their members to be taxed in the same manner as partnerships. The court also noted that there was no dispute that the company properly passed its income and tax liability to its owners. Id. Therefore, like the Park 100 decision, the end result is that the income and the related tax liability of flow through entities that are taxed as partnerships are the responsibility of the partners/members, and the manner in which the taxpayer chooses to define its ownership interest in the company is not relevant for purposes of applying the tax liability . . .

In conclusion, the Department adjusted Taxpayer's adjusted gross income tax return because Taxpayer had failed to include the activities from the two Indiana fabrication plants (one operated by Taxpayer's Division and the other operated by Partnership) in its apportionment factors. Taxpayer, as the reporting entity for Taxpayer's Division, must include the income and activities of the Indiana fabrication plant operated by Taxpayer's Division in its adjusted gross income tax return, including the apportionment factors. IC § 6-3-2-2. In addition, Taxpayer, as the reporting entity for Taxpayer's Division, is a corporate partner in Partnership. Taxpayer, as the corporate partner, is liable for Partnership's adjusted gross income tax in its separate or individual capacity and is required to report its portion of Partnership's Indiana business activity on Taxpayer's Indiana adjusted gross income tax return, pursuant to IC § 6-3-4-11(a). Since Taxpayer owns ninety-nine percent of Partnership, Taxpayer is required to report its ninety-nine percent partner share of Partnership's income and activities in its apportionment factors, as provided in 45 IAC 3.1-1-153. Therefore, Taxpayer's protest of the Department's adjustments to its return to include the operational business income and activities of the two Indiana fabrication plants in Taxpayer's apportionment factors is denied.

#### Indiana Revenue Ruling 2001-04IT (February 19, 2001) *Sourcing*

It is clear from the above regulations that all of a partnership's income is subject to apportionment. Portfolio interest, net Internal Revenue Code Section 1231 loss, long-term capital gain from the sale of securities and from the sale or exchange of goodwill and going concern value, as components of partnership income, therefore, are subject to apportionment at the partnership level.

#### Indiana Pass Through Entity Tax Instructions (2022) *PTE*

Contains an example called [Determining Indiana-Sourced Income in a Multi-Tiered Structure](#). If Partnership B does not make the election to be taxed at the entity level, Partnership B may pass the pass-through entity tax paid on its behalf through to its partners so that the partners can treat the tax as Pass Through Entity Tax. However, it cannot pass a partner more tax than a pro rata share of the Pass Through Entity Tax or the amount of Pass Through Entity Tax computed on the partner's share, whichever amount is greater

Indiana IT-65 Instructions (2022) *Withholding/Return*

**Withholding Amounts on Tiered Partnerships/S Corporations.** A partnership must withhold state income tax at the individual income tax rate on the apportioned distributive shares of partnership income (on current-year earnings derived from Indiana sources) paid or credited to another nonresident partnership or nonresident S corporation. It must do this each time it pays or credits any of its nonresident partners or nonresident S corporations.

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## Iowa

Iowa Admin. Code r. 701-54.6(5) *Sourcing*

A corporation's distributive share of net income or loss from a joint venture, limited liability company, or partnership is subject to apportionment within and without the state. If the income of the partnership, limited liability company, or joint venture is received in connection with the taxpayer's regular trade or business operations, the partnership, limited liability company, or joint venture income shall be apportioned within and without Iowa on the basis of the taxpayer's business activity ratio. The corporation's distributive share of the gross receipts of the partnership, limited liability company, or joint venture shall be included in the computation of the business activity ratio in accordance with the provisions of this chapter.

EXAMPLE 1: A, a corporation with a commercial domicile in State X, is engaged in business within and without Iowa whereby A sells tangible personal property. A also has an interest in a limited partnership whose business is conducted within and without Iowa. Five percent of the limited partnership's gross receipts are derived from the sale of tangible personal property to Iowa purchasers and 95 percent are derived from sales and deliveries to purchasers outside of Iowa. A will include 5 percent of its distributive share of the gross receipts of the partnership in the numerator along with A's destination Iowa sales in calculating its business activity ratio. A will include 100 percent of its distributive share of the gross receipts in the denominator along with A's total sales in calculating its business activity ratio.

EXAMPLE 2: B, a corporation with a commercial domicile in State X, has no physical presence in the state of Iowa. B's only contact with Iowa is B's interest in a limited partnership whose business is conducted within and without Iowa. Ten percent of the limited partnership's gross receipts are derived from the sale of tangible personal property to Iowa purchasers and 90 percent are derived from sales and deliveries to purchasers outside of Iowa. B will include 10 percent of its distributive share of the gross receipts of the partnership in the numerator in calculating its business activity ratio. B will include 100 percent of its distributive share of the gross receipts in the denominator along with B's total sales in calculating its business activity ratio.

Iowa Admin. Code r. 701-302.12 *Sourcing*

Residents engaged in a partnership or limited liability company, even if located or doing business outside the state of Iowa, are taxable upon their distributive share of net

income of such partnership or limited liability company, whether distributed or not, and are required to include such distributive share in their return. A nonresident individual who is a member of a partnership or limited liability company doing business in Iowa is taxable on that portion of net income which is applicable to the Iowa business activity whether distributed or not. See 701—Chapter 401.

Iowa Admin. Code r. 701-302.16(4)(a) *Sourcing*

If a nonresident, or a partnership or trust with a nonresident member, transacts business both within and without the state, the net income must be so apportioned as to allocate to Iowa a portion of the income on a fair and equitable basis, in accordance with approved methods of accounting.

Iowa Admin. Code r. 701-302.16(6) *Sourcing*

When a partnership derives income from sources within this state as determined in 302.16(3) through 302.16(5), the nonresident members of the partnership are taxable only upon that portion of their distributive share of the partnership income which is derived from sources within this state.

Iowa Admin. Code r. 701-302.16(9)(b) *Sourcing*

When a nonresident of Iowa sells or exchanges the individual's interest in a partnership, the nonresident is actually selling an intangible since the partnership can continue without the nonresident partner and the assets used by the partnership are legally owned by the partnership and an individual retains only an equitable interest in the assets of the partnership by virtue of the partner's ownership interest in the partnership. However, because of the unique attributes of partnerships, the owner's interest in a partnership is considered to be localized or "sourced" at the situs of the partnership's activities as a matter of law. *Arizona Tractor Co. v. Arizona State Tax Com'n.*, 566 P.2d 1348, 1350 (Ariz. App. 1997); Iowa Code chapter 486 (unique attributes of a partnership defined). Therefore, if a partnership conducts all of its business in Iowa, 100 percent of the gain on the sale or exchange of a partnership interest would be attributable to Iowa. On the other hand, if the partnership conducts 100 percent of its business outside of Iowa, none of the gain would be attributable to Iowa for purposes of the Iowa income tax. In the situation where a partnership conducts business both in and out of Iowa, the capital gain from the sale or exchange of an interest in the partnership would be allocated or apportioned in and out of Iowa based upon the partnership's activities in and out of Iowa in the year of the sale or exchange.

Iowa Code § 422.16B(4)(b) *Withholding/Return*

A tiered pass-through entity shall be subject to the same requirements to file a composite return and pay tax under this section with respect to the distributive shares of the tiered pass-through entity's income. Any Iowa income or franchise tax paid on the tiered pass-through entity's behalf by another pass-through entity may be applied against that tiered pass-through entity's own composite tax remittance obligation imposed under this section.

Iowa Department of Revenue Website *Withholding/Return*

Nonresident members who are individuals and who are included on the composite return will not be required to file an Iowa income tax return if their distributive share of income from the pass-through entity (or multiple pass-through entities) is their only Iowa-source income. However, nonresident members who are individuals may still want to file an Iowa income tax return to claim their refundable composite tax credit.

Nonresident members who are not individuals will still be required to file an Iowa income or franchise tax return.

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## Kansas

### Kan. Stat. Ann. § 79-3272 *Sourcing*

Any taxpayer having income from business activity which is taxable both within and without this state, other than activity as a financial organization or the rendering of purely personal services by an individual, shall allocate and apportion net income as provided in this act.

### Kan. Admin. Regs. § 92-12-83 *Sourcing*

All business income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in K.S.A. 79-3279 and 79-4301, article IV.9. The elements of the apportionment formula are the property factor, the payroll factor and the sales factor of the trade or business of the taxpayer.

### Kansas Department of Revenue Website *Sourcing*

Information given to the partners receiving income should also include the partner's share of the Kansas and everywhere property, payroll and sales factors of the partnership making the distribution. This information is necessary so the partner receiving the distribution can include those factors with their Kansas and everywhere property, payroll and sales factors in order to properly apportion income to Kansas in their returns when filed.

### Kansas Department of Revenue Website and Instructions to Form K-120S *Sourcing*

Business income is apportioned to Kansas generally using the average of the three factors of property, payroll, and sales. For instance, business income received from another partnership is included in your apportionable income and your share of that partnership is multiplied times the property, payroll and sales both in Kansas and everywhere of that partnership to add to your entity's property, payroll and sales both in Kansas and everywhere. The apportionable income is then multiplied by the resulting factor. Any deviation from using the three factor method requires alternative qualifications. All the apportionment methods are listed in this section.

K.S.A. 79-3279 provides that the use of the three-factor method formula of property, payroll, and sales be used to apportion income to Kansas. Direct or segregated accounting methods will not be allowed unless the taxpayer has petitioned the Secretary of Revenue for use of direct or segregated accounting, and the petition is approved. Direct or segregated accounting will not be allowed only because that is the method used in another state or because partnership income is received from other entity.

### Kansas Salt Parity Act – Frequently Asked Questions *PTE*

If the pass-through entity makes an election, does it make tax payments on behalf of other partnerships and S corporations that are owners of the pass-through entity?

No. Partnerships and S corporation owners are not eligible members. Only individual owners can be taxed under the SALT Parity election.

For this discussion, we have S corporation A who is owned by Individual A (30% ownership), Partnership A (30% owner) and S Corporation B (40% owner). S Corporation A realized \$100,000 in income. Individual A and Partnership A's distributive shares of



income were \$30,000 each. S corporation B's distributive share of income was \$40,000. While the income is passed to each ownership entity, tax is paid only on behalf of Individual A. The tax paid on Individual's A behalf would be \$1,710. Partnership A and S Corporation B could each individually elect to be taxed at the entity level and pay the tax on their individual members' share of distributive income.

Kan. Admin. Regs. § 92-12-106 *Withholding/Return*

(a) Any partnership or S corporation required to file a return under the Kansas income tax act may file a composite income tax return for all nonresident partners or nonresident shareholders that derive income from the partnership or S corporation. Nonresident partners and nonresident shareholders included in a composite return shall not file a separate income tax return.

(b) Any nonresident partner or nonresident shareholder may be included in a composite return unless the partner or shareholder has income from a Kansas source other than the partnership or S corporation.

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## Kentucky

Ky. Rev. Stat. Ann. § 141.206 *Sourcing*

(8) In determining the tax under this chapter, a nonresident individual, estate, or trust that is a partner, member, or shareholder in a pass-through entity required to file a return under subsection (1) of this section shall take into account: (a) 1. If the pass-through entity is doing business only in this state, the partner's, member's, or shareholder's total distributive share of the passthrough entity's items of income, loss, and deduction; or 2. If the pass-through entity is doing business both within and without this state, the partner's, member's, or shareholder's distributive share of the pass-through entity's items of income, loss, and deduction multiplied by the apportionment fraction of the pass-through entity as prescribed in subsection (11) of this section; and (b) The partner's, member's, or shareholder's total distributive share of credits of the pass-through entity.

(9) A corporation that is subject to tax under KRS 141.040 and is a partner or member in a pass-through entity shall take into account the corporation's distributive share of the pass-through entity's items of income, loss, and deduction and:

(a)

1. For taxable years beginning on or after January 1, 2007, but prior to January 1, 2018, shall include the proportionate share of the sales, property, and payroll of the limited liability pass-through entity or general partnership in computing its own apportionment factor; and

2. For taxable years beginning on or after January 1, 2018, shall include the proportionate share of the sales of the limited liability pass-through entity or general partnership in computing its own apportionment factor; and

(b) Credits from the partnership.

(10)

(a) If a pass-through entity is doing business both within and without this state, the pass-through entity shall compute and furnish to each partner, member, or shareholder the numerator and denominator of each factor of the apportionment fraction determined in accordance with subsection (11) of this section.

(b) For purposes of determining an apportionment fraction under paragraph (a) of this subsection, if the pass-through entity is: 1. Doing business both within and without this state; and 2. A partner or member in another pass-through entity; then the pass-through entity shall be deemed to own the pro rata share of the property owned or leased by the other pass-through entity, and shall also include its pro rata share of the other pass-through entity's payroll and sales.

(c) The phrases "a partner or member in another pass-through entity" and "doing business both within and without this state" shall extend to each level of multiple-tiered pass-through entities.

(d) The attribution to the pass-through entity of the pro rata share of property, payroll and sales from its role as a partner or member in another pass-through entity will also apply when determining the pass-through entity's ultimate apportionment factor for property, payroll and sales as required under subsection (11) of this section.

(11)

(a) For taxable years beginning prior to January 1, 2018, a pass-through entity doing business within and without the state shall compute an apportionment fraction, the numerator of which is the property factor, representing twenty-five percent (25%) of the fraction, plus the payroll factor, representing twenty-five percent (25%) of the fraction, plus the sales factor, representing fifty percent (50%) of the fraction, with each factor determined in the same manner as provided in KRS 141.901, and the denominator of which is four (4), reduced by the number of factors, if any, having no denominator, provided that if the sales factor has no denominator, then the denominator shall be reduced by two (2).

(b) For taxable years beginning on or after January 1, 2018, a pass-through entity doing business within and without the state shall compute an apportionment fraction as provided in KRS 141.120.

#### Ky. Rev. Stat. Ann. § 141.121(6) *Sourcing*

A corporation:

- (a) That owns an interest in a limited liability pass-through entity; or
- (b) That owns an interest in a general partnership;

shall include the proportionate share of receipts of the limited liability pass-through entity or general partnership when apportioning income. The phrases "an interest in a limited liability pass-through entity" and "an interest in a general partnership" shall extend to each level of multiple-tiered pass-through entities.

#### 2022 Instructions for Kentucky Pass-through Entity Tax *PTE*

A pass-through entity that is a partner, member, or shareholder of another pass-through entity (lower-tier pass-through entity) shall complete Form PTET-CR to reflect each of the lower tier pass-through entity's partner's, member's, or shareholder's pro rata share of the lower-tier pass-through entity's income. The electing upper-tier pass-through entity must also file a Form 740-PTET and report the proportionate share of the tax paid on behalf of the lower-tier pass-through entity. The upper-tier pass-through entity will claim the PTET-CR from the lower-tier pass-through entity on the estimated payment line on Form 740-PTET, line 9.

## Louisiana

### La. Rev. Stat. Ann. § 47:243(A)(6) *Sourcing*

Estates, trusts and partnerships having a non-resident individual or a corporation as a member or beneficiary shall allocate and apportion their income within and without this state in accordance with the processes and formulas prescribed in this Part, and the share of any such non-resident or corporation member or beneficiary in the net income from sources in this state as so computed, shall be allocated to this state in the return of such member or beneficiary.

### La. Rev. Stat. Ann. § 47:287.93(A)(5) *Sourcing*

For purposes of this Part only, estates, trusts, and partnerships having a corporation as a member or beneficiary shall compute, allocate, and apportion their income or loss within and without this state in accordance with the processes and formulas prescribed by this Part, and the share of any corporation member or beneficiary in the net income or loss from sources in this state so computed shall be allocated to this state in the return of such corporation.

### La. Rev. Stat. Ann. § 47:287.92 *Sourcing*

A. All items of gross income, not otherwise exempt, shall be segregated into two general classes designated as allocable income and apportionable income.

B. Allocable income. The class of gross income to be designated as "allocable income" shall include only the following:

- (1) Rents and royalties from immovable or corporeal movable property.
- (2) Royalties or similar revenue from the use of patents, trademarks, copyrights, secret processes, and other similar intangible rights.
- (3) Income from estates, trusts, and partnerships.
- (4) Income from construction, repair, or other similar services.

C. Apportionable income. The class of income to be designated as "apportionable income" shall include all items of gross income which are not properly includable in allocable income as defined in this Section.

### La. Rev. Stat. Ann. § 47:202(B) *Sourcing*

The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under subsection A(1) through A(3) of this section shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

### Louisiana Department of Revenue Website *Withholding/Return*

Partners who are themselves partnerships cannot be included in a composite return filing.

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## Maine

### Me. Stat. tit. 36, § 5191(2) *Sourcing*

Each item of partnership income, gain, loss or deduction shall have the same character for a partner under this Part as it has for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Me. Stat. tit. 36, § 5191(6) *Sourcing*

A nonresident partner's distributive share of items of income, gain, loss or deduction shall be determined under section 5191, subsection 1. The character of partnership items for a nonresident partner shall be determined under section 5191, subsection 2. The effect of a special provision in a partnership agreement, other than a provision referred to in subsection 3, having as a principal purpose the avoidance or evasion of tax under this Part shall be determined under section 5191, subsection 3. .

Me. Stat. tit. 36, § 5211(1) *Sourcing*

Any taxpayer, other than a resident individual, estate, or trust, having income from business activity which is taxable both within and without this State, other than the rendering of purely personal services by an individual, shall apportion his net income as provided in this section. Any taxpayer having income solely from business activity taxable within this State shall apportion his entire net income to this State.

18-125 Me. Code R. 801 § 7 *Sourcing*

A. Generally. A corporation with an interest in a pass-through entity, such as a partnership, limited partnership, limited liability partnership, limited liability company, S corporation, or other similar entity must include its distributive share of the pass-through entity income, loss, or deduction in calculating its income, in accordance with the Internal Revenue Code and 36 M.R.S. § 5102(8), and must apportion its income pursuant to paragraph D below. The character of any item included in the distributive share is determined as if it were realized or incurred directly by the corporation. The business of the pass-through entity is treated as the business of the corporation.

B. Taxable in Maine. A corporation that is not otherwise subject to Maine's tax jurisdiction is nevertheless taxable in Maine if it is a partner, shareholder or member in a pass-through entity whose activities, if conducted directly by the corporation, would subject the corporation to the Maine corporate income tax.

C. Taxable in another state. A corporation is taxable in another state within the meaning of section .04 above if the corporation is a partner, shareholder or member in a passthrough entity with activities in that state that cause the pass-through entity or its partner, shareholder or member to be taxable in that state under the rules described in section .04 above.

D. Apportionment rules. In general, if a corporate partner, shareholder or member is taxable in another state, it must apportion its taxable net income using the sales factor in 36 M.R.S. § 5211(8).

(1) Sales factor. In determining the denominator of its sales factor, a corporate partner, shareholder or member must include its pro rata share of the passthrough entity's total sales during the pass-through entity's taxable year. In determining the numerator of its sales factor, a corporate partner, shareholder or member must include its pro rata share of such sales in Maine. To avoid duplication, however, the following sales must be eliminated from both the numerator and denominator of the sales factor:

(a) Sales by the corporation to the pass-through entity in an amount equal to the total of such sales multiplied by the corporation's interest in the passthrough entity; and

(b) Sales by the pass-through entity to the corporation in an amount not to exceed the total of all sales made by the pass-through entity multiplied by the corporation's interest in the pass-through entity.

(2) Pro rata share. For purposes of this section, a corporate partner's, shareholder's or member's pro rata share of a pass-through entity's sales shall be its percentage interest in pass-through entity profit or loss for the taxable year, as stated on the partner's, shareholder's or member's Schedule K-1. However, if, under the pass-through entity agreement, a partner's, shareholder's or member's share of gain or loss from the sale of particular pass-through entity assets is different from its profit or loss ratio stated on Schedule K-1, gross receipts from sales of such assets shall be attributed to its sales factor in the same proportion as the partner's, shareholder's or member's interest in gain or loss from the sale. In the event of a termination or other change in a partner's, shareholder's or member's interest during the taxable year, the partner's, shareholder's or member's pro rata share of sales must be modified to reflect pass-through entity sales during the actual period that the partner, shareholder or member held its interest.

#### 18-125 Me. Code R. 805 § 2(D) *Withholding/Return*

Composite returns for tiered entity structure. An upper tier entity may file a single composite return on behalf of the non-resident members (including members, partners, shareholders, or beneficiaries) in a tiered entity structure, where the nonresident members are eligible persons. The following additional requirements must be met:

1. Each of the lower tier entities (including any related pass-through entity) with individual members that elect to participate must agree to have its electing members included in the composite return and each lower tier entity must not file a separate return;
2. A schedule must be attached to the composite return indicating each member's distributive share of Maine-source income from each tiered entity, and the total amount of Maine-source income received by each member from all tiered entities in the tiered entity structure; and
3. A statement must be attached to the composite return, including an organizational chart, disclosing the structure and identity, including the names, addresses and federal identification numbers, of all the related entities from which participating nonresident members directly or indirectly derived Maine-source income.

#### 18-125 Me. Code R. 803 § 6 *Withholding/Return*

##### B. Tiered pass-through entity structures

1. A tiered-entity structure is one in which some or all of the ownership interest in one pass-through entity (lower-tier entity) is held by a second pass-through entity (upper-tier entity). A tiered-entity structure may have two or more tiers.
2. Unless exempt pursuant to this rule or by the Assessor, either by ruling on a specific request or in published instructions, a pass-through entity must withhold for its non-resident members, including members who are pass-through entities. To prevent multiple withholding on the same income, an upper-tier entity that recognizes distributive income is not required to withhold from nonresident member income generated by a lower-tier entity if the lower-tier entity has already withheld from that income. The

upper-tier entity, however, must separately report to its members on Form 1099ME their proportionate distributive share of amounts withheld by the lower-tier entity.

3. Upon written application, and with the approval of the Assessor, a lower-tier entity may meet its withholding obligation for an upper-tier entity by directly withholding from the distributive income of the nonresident members of the upper-tier entity. If approval is granted, the lower-tier entity is required to report on Form 1099ME directly to the nonresident members the amounts withheld.

#### C. Exemptions

1. Automatic exemptions. A pass-through entity is not required to withhold tax for a nonresident member if any of the following applies:

(a) The nonresident member's Maine-source member income from the entity will be less than \$1,000 for the current year.

(b) The nonresident member is a tax-exempt entity under either Maine law or federal law (including IRAs, Keoghs, pension and profit-sharing plans, and other such organizations), unless the Maine-source member income of the tax-exempt entity is unrelated business income.

(c) The nonresident upper-tier pass-through entity realizes income from a lower-tier entity and the lower-tier entity has already withheld from that income.

(d) The entity is a publicly traded partnership that is treated as a partnership under Code § 7704.

(e) The nonresident member is a publicly traded partnership that is treated as a partnership under Code § 7704.

(f) The entity is prohibited under federal or state law from making distributions to members; the exemption applies only for years in which distributions are prohibited under federal or state law. Contractual restrictions on distributions, such as loan covenants or organizational documents, do not qualify an entity for this exemption.

2. Compliant taxpayer exemption. To be exempt under the compliant taxpayer exemption, each nonresident member must sign and submit to the entity a Nonresident Member Affidavit and Agreement to Comply with Maine Income Tax (Form 941AF-ME). The exempt status of each nonresident member submitting an affidavit must be reported on the Pass-through Entity Withholding Form 941P-ME filed for the calendar year. The nonresident member must not have been previously disqualified from this exemption and must continue to stay in compliance by submitting required returns.

3. Composite filing exemption. A composite filing is a simplified group income tax return filed by a pass-through entity on behalf of two or more participating eligible persons as defined in MRS Rule 805.01(C) (18-125 C.M.R., ch. 805.01(C)) that are nonresident members of such pass-through entity. To be allowed a composite filing exemption, the entity must collect a Nonresident Member Affidavit and Agreement to Participate in a Composite Filing of Maine Income Tax (Form 941CF-ME) from each nonresident member that is participating in the composite filing. The exempt status of each nonresident member participating in a composite filing must be reported on the Pass-through Entity Withholding Form 941P-ME filed for the calendar year. The entity must also make estimated payments on behalf of the composite filing group. The entity must file the composite return, including Schedule 1040C-ME, even if there is no tax liability for the group. Composite return requirements are outlined in MRS Rule 805 (18-125 C.M.R., ch. 805).

4. Requested exemptions. An exemption applies if the Assessor has determined in writing, and subject to any conditions that may be imposed, that the nonresident member's Maine-source member income is exempt from withholding.

5. Revocation of exemptions. The Assessor may revoke an exemption at any time. If an exemption is revoked, the entity will be notified in writing and must begin withholding immediately.

#### Maine Pass-through Entity Withholding FAQ *Withholding/Return*

#### **Is an upper-tier entity required to report amounts withheld by a lower-tier entity on Form 941P-ME?**

An entity should report only those amounts withheld directly by that entity. In this case, the lower-tier entity must file Form 941P-ME and report the amounts it withheld. However, the upper-tier entity must issue Forms 1099ME to its members and report in Form 1099ME, box 2 each member's share of the amount withheld by the lower-tier entity. Additionally, the upper-tier entity must also file Form 941P-ME to report its Maine-source income.

**I represent an upper-tier entity with Maine-source income only from a lower-tier entity. How can I be sure the lower-tier entity is withholding so that I don't have to do it?**

The lower-tier entity must withhold from its upper-tier members unless it obtains Form 941AF-ME from an upper-tier entity to be exempt. At the end of the year, the lower-tier entity is required to provide the upper-tier entity with Form 1099ME showing the portion of withholding for the year that is attributable to that upper-tier entity. The upper-tier entity then provides its members with Form 1099ME reporting their proportionate distributive share of the withholding in box 2.

**Is an upper-tier entity required to report amounts withheld by a lower-tier entity on Form 941P-ME?**

An entity should report only those amounts withheld directly by that entity. In this case, the lower-tier entity must file Form 941P-ME and report the amounts it withheld. However, the upper-tier entity must issue Forms 1099ME to its members and report in Form 1099ME, box 2 each member's share of the amount withheld by the lower-tier entity. Additionally, the upper-tier entity must also file Form 941P-ME to report its Maine-source income.

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## Maryland

### Maryland Income Tax Administrative Release No. 12 (2008) *Sourcing*

Corporate partners that are unitary businesses and have nexus with Maryland are required to allocate their share of partnership income using an appropriate apportionment method. The apportionment method applies if either the corporate partner or the partnership is conducting business in Maryland.

In general, the partnership share of income is apportioned in the same manner as other income allocable to this State. For example, a corporation using a three-factor apportionment formula includes in both the numerator and denominator of each of the factors not only its own property, payroll, and sales, but also adds to such amounts its share of the partnership's property, payroll, and sales. The sales factor is double weighted in the three-factor apportionment formula. The income allocation is then determined by applying the average of the ratios of all property, payroll, and sales (both corporate and partnership) to the corporation's Maryland net income. In this manner, the corporation arrives at its Maryland taxable income attributable to business conducted in Maryland.

The above procedure applies if either the corporation or the partnership is conducting business in this State. For example, a foreign corporation, whose only connection with Maryland is a partnership interest in a partnership that is doing business in Maryland, will report on its Maryland tax return its federal taxable income and compute its Maryland taxable income by use of the apportionment formula that includes the foreign corporation's share of the partnership's apportionment factors, both numerator (Maryland) and denominator (everywhere).

Similarly, a corporation (whether foreign or domestic) that carries on its trade or business in Maryland will compute its apportionment formula by adding to both the numerator and denominator of the corporation's property, payroll, and sales, the corporate partnership share of the partnership's property, payroll, and sales.

Md. Code Regs. 03.04.03.08(F)(2) *Sourcing*

A corporation's share of partnership or joint venture receipts, property, and wages shall be included in the apportionment formula:

- (a) To the extent of the factors required; and
- (b) In the same manner as if they were direct receipts, property, and wages of the corporation.

Md. Code Regs. 03.04.07.02(D)(1) *Sourcing*

A multi-state pass-through entity that is a partnership (including a limited liability company taxed as a partnership and a business trust taxed as a partnership) shall allocate income to this State using:

- (a) The apportionment formula for corporations under COMAR 03.04.03.08A—E; or
- (b) Separate accounting.

Md. Code Ann., Tax-Gen § 10-401 *Sourcing*

In computing the adjustments under §§ 10-206 and 10-210 of this title, a nonresident shall allocate to the State income, losses, or adjustments derived in connection with a business that is carried on both in and out of the State and of which the nonresident is a partner, shareholder of an S corporation, or proprietor, or in connection with an occupation, profession, or trade carried on both in and out of the State by:

- (1) separate accounting, if the Comptroller allows; or
- (2) the method that the Comptroller requires to determine fairly the part of the income derived from or reasonably attributable to the trade, business, profession, or occupation carried on in the State.

Md. Code Ann., Tax-Gen § 10-102.1(f)(1)(ii) *Withholding/Return*

A member of a pass-through entity that is itself a pass-through entity as described in subparagraph (i) of this paragraph shall itself comply with the provisions of this section.

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## Massachusetts

830 Mass. Code Regs. 63.38.1 *Sourcing*

(1)(b) General Rule. All of a taxpayer's taxable net income is allocated to Massachusetts if the taxpayer does not have income from business activity which is taxable in another state. If a taxpayer has income from business activity which is taxable both in Massachusetts and in another state, then the part of its net income derived from business carried on in Massachusetts is determined by multiplying all of its taxable net income by the three factor apportionment percentage as provided in M.G.L. c. 63, § 38(c) through (g) and 830 CMR 63.38.1. If a taxpayer with a Massachusetts commercial domicile has income from business activity which is taxable both in Massachusetts and in



another state but also has an income stream that is prohibited from being taxed in another non-domiciliary state by reason of the U.S. Constitution, that income stream shall be allocated in full to Massachusetts.

(4)(c) Burden of Proof. Except as provided in 830 CMR 63.38.1(4)(d) (relating to corporate limited partners), all income of a single taxpayer (whether derived directly or through agents, partnerships, or other entities whose activities are attributed to the taxpayer) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that, in the aggregate, the related business factors at 830 CMR 63.38.1(4)(b), do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the underlying assets and their acquisition, maintenance, and management were, in fact, unrelated to the taxpayer's business activities in the Commonwealth.

(4)(d) Presumption of Unrelated Business Activity of Corporate Limited Partners. In cases where a corporate limited partner owns, either directly or indirectly (including all interests of any party whose direct or indirect stock ownership would be attributed to the corporate limited partner under the provisions of 26 U.S. Code § 318), less than 50% of either the capital or profit interests of a partnership and the business activity of the limited partnership is attributed to the corporate limited partner under 830 CMR 63.39.1(8), the business activity of the limited partnership is presumed to be unrelated to the corporation's other business activities unless the Commissioner or the taxpayer rebuts this presumption. If the business activities of the partnership and the corporate limited partner are unrelated, then the corporate limited partner must separately account for its income from the holding or disposition of its limited partnership interest and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity. The separate accounting shall apply both to the determination of income subject to apportionment under M.G.L. c. 63, § 2A, 38 or 42, and to the determination of the non-income measure under M.G.L. c. 63, § 39(a)(1).

Either the Commissioner or a taxpayer may rebut the presumption of unrelated business activity by demonstrating that the corporate limited partner and the partnership are engaged in a unitary business. If a corporate limited partner has engaged in a unitary business with the partnership in one or more taxable years, the corporate limited partner may not separately account in any such taxable year for the income it derives from the partnership. Instead, the corporate limited partner shall apportion to Massachusetts all income derived from business activity carried on within the commonwealth, including income derived from its partnership interest, in accordance with the rules of M.G.L. c. 63, § 2A, 38 or 42 using the corporate limited partner's own property, payroll, and sales plus its pro rata portion of the partnership's property, payroll, and sales to determine an apportionment percentage.

Example 1. Corporation A, which is domiciled outside of Massachusetts, owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Corporation A does not conduct business in Massachusetts. Neither Corporation A nor the Commissioner rebuts the presumption that the business activities of Corporation A and Partnership A are unrelated. Corporation A must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Corporation A's other activities is

not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income.

Example 2. Corporation B, which is domiciled outside of Massachusetts, conducts business in Massachusetts and, in addition, owns a minority limited partnership interest in Partnership B. Partnership B does not conduct business in Massachusetts. Neither Corporation B nor the Commissioner rebuts the presumption that the business activities of Corporation B and Partnership B are unrelated. Income from Corporation B's holding or disposition of its interest in Partnership B is not subject to Massachusetts tax jurisdiction and is excluded from the Corporation's taxable net income. Corporation B must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities.

Example 3. Corporation C is domiciled in Massachusetts and holds a minority limited partnership interest in Partnership C. Partnership C may or may not be engaged in business in Massachusetts. Neither Corporation C nor the Commissioner rebuts the presumption that the activities of Corporation C and Partnership C are unrelated. Corporation C must separately apportion to Massachusetts income derived from its interest in Partnership C, using the apportionment factors derived from the partnership's activity. Corporation C must apportion the balance of its income to Massachusetts using the apportionment factors derived from its other activities. The taxable net income of Corporation C is the sum of these separately apportioned amounts.

(12) Corporate Partners. A corporation with an interest in a partnership must include its distributive share of the partnership income, loss, or deduction in calculating its income, in accordance with 26 U.S. Code and M.G.L. c. 63. The character of any item included in the distributive share is determined as if it were realized or incurred directly by the corporation. Except as otherwise provided, the trade or business of the partnership is treated as the trade or business of the corporation. For purposes of determining whether the corporation is a mutual fund service corporation or a Section 38 manufacturer, the corporation's pro rata share (as defined in 830 CMR 63.38.1(12)(f)) of all of the partnership's items, factors and activities shall be taken into account to the extent relevant to the determination, whether or not the corporation and the partnership are engaged in related business activities. If the partnership and corporate partner are engaged in related business activities, the corporation's pro rata share (as defined in 830 CMR 63.38.1(12)(f)) of partnership property, payroll, and sales are included in the partner's apportionment factors, subject to the special rules provided in 830 CMR 63.38.1(12)(d). (Except as otherwise expressly stated, the partnership rules provided in 830 CMR 63.38.1(12) presume that a partnership and corporate partner are engaged in related business activities.)

(a) Taxable in Massachusetts.

1. A corporation that is not otherwise subject to Massachusetts tax jurisdiction is nevertheless taxable in Massachusetts if it is a general partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. See 830 CMR 63.39.1(8).

2. In general, a corporation that is not otherwise subject to Massachusetts tax jurisdiction is taxable in Massachusetts if it is a limited partner in a partnership whose activities, if conducted directly by the corporation, would subject the corporation to the excise under M.G.L. c. 63, § 39. However, as provided in 830 CMR 63.38.1(4)(d), the business activities of the partnership and the corporate limited partner are, in certain circumstances, presumed to be unrelated, so that unless the presumption is rebutted, such partner is taxable in Massachusetts only with respect to the partnership activity. Moreover, under the circumstances described in 830 CMR 63.39.1(8)(b) through (d) (relating to certain partnerships dealing in securities, publicly traded partnerships, and

certain de minimis limited partnership holdings), the activities of the partnership are not attributed to the corporation, and the corporation is not taxable in Massachusetts merely by virtue of holding such a limited partnership interest.

(b) **Taxable in Another State.** A corporation is taxable in another state within the meaning of 830 CMR 63.38.1(5) if the corporation is a general partner in a partnership with business activities in that state that cause either the partnership or its partners to be taxable in that state described in 830 CMR 63.38.1(5). A corporation that is a limited partner in a partnership with business activity in another state is taxable in another state within the meaning of 830 CMR 63.38.1(5) if and to the extent that the corporation would be taxed in Massachusetts under the same facts and circumstances that exist in the other state. A corporation holding a limited partnership interest in a partnership that does business in another state is taxable in the other state for purposes of apportioning its partnership income, but not for purposes of apportioning income from its other business activities, unless the corporate partner and the partnership are engaged in related business activities, or unless the corporate partner is separately taxable in the other state on the basis of its other (unrelated) business activities.

(c) **Income Measure of the Excise.** When computing its net income for the taxable year, a corporation must include its distributive share of partnership items for any partnership year ending with or within its taxable year. The following examples illustrate the application of 830 CMR 63.38.1(12)(c):

1. Corporation C holds a 20% profits interest in Partnership P. C's income for the year was \$1,000,000 and P's income for the same year was \$800,000. The income of C is \$1,160,000 (\$1,000,000 plus 20% of \$800,000).

2. Corporation C holds a 90% profits interest in Partnership P. C incurred a loss of \$500,000 for the year but P's income was \$1,000,000. The income of C is \$400,000 (90% of \$1,000,000 = \$900,000 less the loss of \$500,000).

(d) **Special Apportionment Rules.** In general, if a corporate partner is taxable in another state, it must apportion its taxable net income using the apportionment percentage in M.G.L. c. 63, § 38. However, the following shall apply:

1. **Property Factor.** In determining the denominator of its property factor, a corporate partner must include its pro rata share of the total value of the partnership's real and tangible personal property, owned or rented, used during the partnership's taxable year. In determining the numerator of its property factor, a corporate partner must include its pro rata share of the value of such property located in Massachusetts.

a. In order to avoid duplication, however, certain adjustments must be made to the value of any property leased or rented by the corporation to the partnership or vice versa.

i. Where a corporation rents property to the partnership, it must include the original cost of the property in its property factor. No portion of the value of this property as rental property of the partnership is included.

ii. Where the partnership rents property to the corporation, the corporation includes in its property factor the sum of:

A. the original cost of the property multiplied by the corporation's percentage of interest in the partnership; plus

B. eight times the net annual rental rate of the property, multiplied by the difference between 100% and the corporation's percentage of interest in the partnership.

b. The following examples illustrate the application of 830 CMR 63.38.1(12)(d)1.:

i. Corporation C has a 20% profits interest in Partnership P. C owns a building (original cost \$100,000) which it rents to Pat a fair market rate of \$12,000 per year. C must include the \$100,000 original cost of the building in its property factor. No portion of the value of the property as rental property of the partnership is included in C's property factor.

ii. The facts are the same as in the previous example except that P owns the building and rents it to C. C will include \$20,000 (20% of \$100,000) in its property factor because of its interest in P. C will also include \$76,800  $([\$12,000 \times 8] \times 80\%)$  in its

property factor to account for the rented building used in its operations. Thus, the building's value in C's property factor is \$96,800 (\$20,000, plus \$76,800).

2. Payroll Factor. In determining the denominator of its payroll factor, a corporate partner must include its pro rata share of the total compensation paid by the partnership during the partnership's taxable year. In determining the numerator of its payroll factor, a corporate partner must include its pro rata share of such compensation paid in Massachusetts during the taxable year. The following example illustrates the application of 830 CMR 63.38.1(12)(d)2.:

Corporation C has a 20% profits interest in Partnership P. C's own payroll is \$1,000,000, half of which is attributable to Massachusetts employees, and P's payroll is \$800,000, one quarter of which is attributable to Massachusetts employees. The denominator of C's payroll factor is \$1,160,000 (\$1,000,000, plus 20% of \$800,000, or \$160,000). The numerator of C's payroll factor is \$540,000 (50% of \$1,000,000 plus 25% of \$160,000).

3. Sales Factor. In determining the denominator of its sales factor, a corporate partner must include its pro rata share of the partnership's total sales during the partnership's taxable year. In determining the numerator of its sales factor, a corporate partner must include its pro rata share of such sales in Massachusetts.

a. In order to avoid duplication, however, the following sales must be eliminated from both the numerator and denominator of the sales factor:

- i. sales by the corporation to the partnership in an amount equal to the total of such sales multiplied by the corporation's profits interest in the partnership; and
- ii. sales by the partnership to the corporation in an amount not to exceed the total of all sales made by the partnership multiplied by the corporation's profits interest in the partnership . . .

(f) Pro Rata Share. For purposes of 830 CMR 63.38.1(12), a partner's pro rata share of a partnership's items, factors and activities shall be its percentage interest in partnership profit or loss for the taxable year, as stated on the partner's Schedule K-1, provided however, that if, under the partnership agreement, a partner's share of gain or loss from the sale of particular partnership assets is specially allocated in a manner different from its profit or loss ratio stated on Schedule K-1, and such special allocation has "substantial economic effect" as defined in Treas. Reg. § 1.704-1(b)(2), gross receipts from sales of such assets shall be assigned to its sales factor in the same proportion as the partner's interest in gain or loss from the sale. In the event of a termination or other change in a partner's interest during the taxable year, the partner's pro rata share of payroll and sales must be modified to reflect partnership payroll and sales during the actual period that the partner held its interest.

#### 830 Mass. Code Regs. 62.5A.1(1) *Sourcing*

The income of a pass-through entity that derives from or is effectively connected with the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts retains its character as it passes through a tiered structure of pass-through entities before becoming income to the non-resident. Thus, income that is derived from a trade or business does not convert to non-business-related income as it passes through a series of entities. Similarly, Massachusetts source income of any pass-through entities engaged in a unitary business that conducts a trade or business in Massachusetts is taxable to a non-resident member to the extent it would be taxable if received directly by the non-resident.

In the case of multi-tiered unitary businesses where at least one entity in the structure is engaged in the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts, and income derived from one or more members of the unitary business is taxable in another state, the group of entities must apportion its income, as determined under this regulation.

#### 830 Mass. Code Regs. 62.5A.1(2) *Sourcing*

Tiered Structure, a pass-through entity that has a pass-through entity as a member. As between two entities, the pass-through entity that is a member is the upper-tier entity, and the entity of which it is a member is the lower-tier entity. A tiered pass-through entity arrangement may have two or more tiers; in such cases, a single entity can be both a lower-tier and an upper-tier entity.

#### 830 Mass. Code Regs. 62.5A.1(3) *Sourcing*

The Massachusetts income tax is imposed on the Massachusetts source income earned or derived by non-residents. Massachusetts source income includes the following types of income, but excludes items of income set forth in 830 CMR 62.5A.1(4):

(a) Income Derived from or Effectively Connected with a Trade or Business, Including Any Employment Carried on in Massachusetts. This income is defined as the income that is earned by, credited to, accumulated for or otherwise attributable to the taxpayer's trade or business in the Commonwealth in any year or part thereof, regardless of the year in which the income is actually received by the taxpayer and regardless of the taxpayer's residence or domicile in the year it is received. All types of income, including investment income, derived from or effectively connected with the carrying on of a trade or business within Massachusetts are Massachusetts source income. The term may include gain from the sale of a business or an interest in a business, distributive share income, separation, sick or vacation pay, deferred compensation and nonqualified pension income not prevented from state taxation by the laws of the United States, and income from a covenant not to compete.

##### 1. "Trade or business, including any employment."

a. General Rule. Subject to the exception that applies to presence for business that is casual, isolated, or inconsequential, described at section 830 CMR 62.5A.1(3)(h), below, a non-resident has a trade or business, including any employment carried on in Massachusetts:

i. If the non-resident, directly or through representatives or employees, maintains or operates or shares in maintaining or operating any place in Massachusetts where business affairs are systematically and regularly conducted;

ii. If the non-resident owns an interest in a pass-through entity that, directly or through representatives or employees, or through other pass-through entities, maintains or operates or shares in maintaining or operating any place in Massachusetts where its business affairs are systematically and regularly conducted;

iii. If the non-resident, directly or through representatives or employees, is present for business in Massachusetts either as an employee or as a sole proprietor or other self-employed individual, or if the non-resident owns an interest in a pass-through entity that, directly or through representatives or employees or through other pass-through entities, is present for business. All activities that are considered a "trade or business," including employment, under Massachusetts and/or federal tax law are subject to taxation in Massachusetts under G.L. c. 62, § 5A. Income from a trade or business generally includes that gross income against which trade or business expense deductions are allowable under sections 62 and 162 of the Code. See G.L. c. 62, § 1(l), IRC §§ 62, 162, Treas. Reg. §§ 1.161-1 - 1.162-29;

iv. If the non-resident licenses intangibles, including trademarks or patents, directly or through representatives or employees, for use in Massachusetts on an ongoing basis...

(b) Income from a Pass-Through Entity that is Derived from or Effectively Connected with a Trade or Business, Including Any Employment Carried on in Massachusetts.

1. General rule. The activities of a pass-through entity are attributed to its individual members. A non-resident member of a pass-through entity is therefore engaged in the conduct of the trade or business of the pass-through entity of which it is a member, and thus is taxable on the Massachusetts source income of the entity. The character of any item of income, loss, deduction or credit included in the member's distributive share is determined as if it were realized directly by the member from the source from which realized by the pass-through entity, or incurred in the same manner as incurred by the pass-through entity. The principles in this paragraph shall apply in the case of an ownership chain that runs through multiple pass-through entities. For example, if a non-resident individual is a member of a pass-through entity that, in turn, is a member of a lower-tier pass-through entity that is engaged in a trade or business in Massachusetts, then the non-resident will be taxable on its share of the Massachusetts source income derived from the trade or business conducted by the lower-tier entity.

The income derived by a non-resident limited partner of a Massachusetts limited partnership engaged exclusively in buying, selling, dealing in or holding securities on its own behalf and not as a broker, is not subject to the Massachusetts income tax. See G.L. c. 62, § 17(b). The Massachusetts source income derived by a non-resident general partner of such a partnership is subject to Massachusetts income tax, provided the partnership is engaged in the conduct of a trade or business in the Commonwealth, or owns or leases real property in the Commonwealth.

2. Multiple pass-through entities that are not engaged in a unitary business. In the case of multiple pass-through entities that are not engaged in a unitary business, the pass-through entities must identify the Massachusetts income or loss, reporting that amount to its members, allocated or apportioned as appropriate pursuant to 830 CMR 62.5A.1(6). That income must retain its identity as Massachusetts source income, and be reported as such to members as it passes through multiple pass-through entities, without further apportionment.

Example (3)(b)(2). Florida domiciled LLC ("Florida LLC") has three non-resident members. Florida LLC owns a Massachusetts domiciled LLC ("Massachusetts LLC") that invests in securities on its own behalf and is not engaged in a trade or business. Florida LLC owns a New York domiciled LLC ("New York LLC") that has an office in Boston that offers management services and advice to Massachusetts LLC and receives a fee from Massachusetts LLC based on a percentage of the portfolio value of Massachusetts LLC. Florida LLC also owns Real Estate LLC, commercially domiciled in Utah, but which owns an office tower in Boston and collects rents on that. Real Estate LLC is not engaged in a unitary business with the other members of the group.

Taxation of non-resident members of Florida LLC. The Massachusetts source income of Real Estate LLC, determined pursuant to the allocation and apportionment rules of 830 CMR 62.5A.1(6), is identified and reported to Florida LLC, and is taxable to the non-resident members. It is not subject to further apportionment under 830 CMR 62.5A.1(6) at the level of Florida LLC. Income from Massachusetts LLC is not subject to Massachusetts taxation to the non-resident members, because Massachusetts LLC only invests in securities on its own behalf. The Massachusetts source income derived from New York LLC, determined pursuant to the allocation and apportionment rules of 830 CMR 62.5A.1(6)(a), is taxable because the management company is engaged in the conduct of a trade or business in Massachusetts. The income of the group is not subject to the apportionment provisions described at 830 CMR 62.5A.1(6)(b), below, because the entities subject to Massachusetts taxation are not engaged in a unitary business.

3. Multiple pass-through entities engaged in a unitary business. In the case of multiple pass-through entities that are engaged in a unitary business, the income of any entity in the structure that derives from or is effectively connected with the conduct of a trade or business or the ownership of real or tangible personal property in Massachusetts retains its character as it passes through the structure. Thus, business income of a pass-

through entity does not convert to non-business income as it passes through a series of pass-through entities engaged in related business activities, as that term is defined in 830 CMR 62.5A.1(2), and is further explained in 830 CMR 62.5A.1(6). Investment income of a pass-through entity that would be taxable as business income if received directly by a non-resident member engaged in business in Massachusetts is treated as taxable income of the non-resident. Note that business income can include investment income that the pass-through entity or entities derives from an operational function.

Example (3)(b)(3). A non-resident is a member of a Nevada LLC. The Nevada LLC sells computer software, and has an 80% ownership interest in a Partnership that develops computer software in Massachusetts. The partnership is treated as a partnership for federal and Massachusetts tax purposes. The income of the Partnership flows through the LLC to non-resident members. The LLC and the Partnership are functionally integrated, and are a unitary business. Subject to the apportionment rules found at 830 CMR 62.5A.1(6), below, the income of the Partnership that is passed through to the non-resident shareholders is Massachusetts source income.

(c) Specific types of Massachusetts source income. If a non-resident has a trade or business, including any employment, carried on in Massachusetts, Massachusetts source income includes, among other things . . .

#### 830 Mass. Code Regs. 62.5A.1(6) *Sourcing*

Rules for Allocation or Apportionment of Income to Massachusetts for Non-resident Members of Pass-through Entities. A pass-through entity that earns or derives income from sources both within Massachusetts and elsewhere must either allocate or apportion the income to determine the amount of Massachusetts source income of its non-resident members, using the following allocation and apportionment provisions. 830 CMR 62.5A 1(6) applies to pass-through entities with non-resident members that have Massachusetts source income. Non-resident individuals use the rules at 830 CMR 62.5A.1(5). The Commissioner may by rule or other public statement create alternate allocation and apportionment methods.

(a) General. A pass-through entity that has income that is taxable both within and outside of Massachusetts must report the member's apportioned share of income to the member. To arrive at the apportioned income figure, the pass-through entity must multiply its taxable net income by the apportionment percentage determined under M.G.L. c. 63, § 38(c) through (g) and 830 CMR 63.38.1. For Massachusetts purposes, the pass-through entity's income subject to apportionment is its entire net income derived from its related business activities, as that term is defined at 830 CMR 62.5A.1(2), and further described at 830 CMR 62.5A.1(6)(d), within and outside of Massachusetts. The entity's income subject to Massachusetts tax is its apportioned net income derived from its related business activities, plus any other income subject to the tax jurisdiction of Massachusetts. Guaranteed payments made to pass-through entity members are treated as other income of the pass-through entity is treated, and are subject to the apportionment rules in 830 CMR 62.5A.1(6)(a).

(b) Treatment of Multiple Pass-through Entities Engaged in a Unitary Business. If a passthrough entity has Massachusetts source income and is related to one or more other pass-through entities in a unitary business, including non-Massachusetts businesses that are in a unitary relationship, the entire income derived from the related activities of the members of the unitary business is subject to Massachusetts apportionment. The method of apportionment is to take the pro rata share of the factors of each entity in the unitary structure, and to aggregate the result for the entire group, according to the method in the following example. The non-resident members will report as Massachusetts source income their apportioned share of income of the entire unitary business.

Example (6)(b)(1.1). General Partnership (General) has a 50% interest in Subsidiary Partnership (Subsidiary); the entities are engaged in a unitary business. General has the following apportionment factors attributable to Massachusetts, presented as a fraction of Massachusetts activity divided by activity everywhere: Property, 25/100; Payroll, 50/100; Sales, 1000/10,000. General has income of \$1,000. Subsidiary has the following apportionment factors, presented as a fraction of Massachusetts activity divided by activity everywhere: Property, 10/100; Payroll, 50/100; Sales, 1000/10,000. Subsidiary has a loss of \$500. The Massachusetts income of the unitary group is calculated as follows: Income = \$1,000 (General's income) - \$250 (representing half the loss of Subsidiary; half because General has a 50% interest in Subsidiary) = \$750. The \$750 income figure must be multiplied by the blended apportionment factors. The blended factors are determined by adding the full factor of General to half the value of Subsidiary's factors (again, because of the 50% ownership). Thus the blended property factor is  $(25 + 5)/(100 + 50) = 30/150$ ; the blended payroll factor is  $(50 + 25)/(100 + 50) = 75/150$ ; the blended sales factor (to be counted twice according to the double weighted sales factor rule) is  $[(1000 + 500)/(10,000 + 5,000)] = 1,500/15,000$ ; the sum of these factors is then divided by four to yield the following result:  $.2 + .5 + .1 + .1 = .9 / 4 = .225$ .

(c) Treatment of Income Derived from Unrelated Activities. If the unitary business subject to Massachusetts apportionment has income derived from unrelated business activities, as determined under 830 CMR 62.5A.1(6)(d), these items of income will be excluded from the taxpayer's taxable net income and will not be apportioned to Massachusetts if Massachusetts does not have jurisdiction to tax the items of income under the Constitution of the United States. Income derived from unrelated business activities will be allocated to Massachusetts when the entity's commercial domicile is Massachusetts. The unitary business must report to the non-resident taxpayer, and the non-resident taxpayer must disclose on his or her return, the nature and amount of any item of income that is derived from unrelated business activities and is excluded from (or is excludable from) taxable net income. The taxpayer must also disclose and exclude expenses allocable in whole or part to such unrelated business activities. Any property, payroll, or sales derived from unrelated business activity are excluded from the taxpayer's apportionment factors.

Example (6)(c)(1). Massachusetts LLC owns a commercial real estate property that it leases, both to its parent, a Partnership that gives investment advice to clients, and to other unrelated tenants. The Partnership, in turn, is owned by three Owner LLCs, all of which have a commercial domicile in other states. The Owner LLCs own the interests in the Partnership, as well as other business ventures, such as a manufacturing corporation in South Carolina and a public utility corporation in North Dakota. The manufacturing corporation and the utility corporation are not in a unitary business with other entities, nor do they have any contacts with Massachusetts. The Massachusetts LLC and the Partnership have centralization of management and a flow of value between the entities, and comprise a unitary business. In determining the Massachusetts source income of the Owner LLC members, the Massachusetts LLC and the Partnership must combine their taxable net income and calculate the Massachusetts apportionment percentage based on their combined property, payroll, and sales. The unitary business will exclude the income of the manufacturing corporation and the public utility corporation from this determination, and will not take into account any of the property, payroll, or sales of the two corporations in calculating the Massachusetts apportionment percentage of the unitary business.

(d) Related Business Activities.

1. Definition.

a. General Rule. Related business activities are activities where there is a sharing or exchange of value between the segments of a single entity or multiple entities such that the activities are mutually beneficial, interdependent, integrated, or such that they



otherwise contribute to one another, as generally described under the discussion of the unitary business principle in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992). The rules that apply to corporations, found at 830 CMR 63.38.1(4), generally apply to pass-through entities as they are applicable, with certain modifications set forth in 830 CMR 62.5A.1. In general, any two segments or activities of a single pass-through entity are related business activities unless the two segments or activities are not unitary. In addition, the following activities are related business activities notwithstanding the absence of a unitary relationship:

i. the short term investment of capital in a non-unitary business segment or activity; and

ii. any other investment of capital that serves an operational function.

b. Income from Cash, Cash Equivalents, and Short-term Securities. Interest or other income from cash deposits, cash equivalents, and short-term securities is considered related business income if such capital serves or performs an operational function. Without limitation, examples of operational functions include: the use or holding of funds as working capital or reserves; the use or holding of funds to maintain a favorable credit rating (e.g. by maintaining a strong current or quick asset ratio); the use or holding of funds to self-insure against business risks; and the interim investment of funds pending their future use in the taxpayer's business.

2. Burden of Proof. Except as provided in 830 CMR 62.5A.1(6)(d)(3) (relating to passthrough entity limited partners), all income of a single pass-through entity (whether derived directly or through representatives, or other pass-through entities) is presumed to be income from related business activities until the contrary is established. Either the taxpayer or the Commissioner may assert that an item of a taxpayer's income is derived from unrelated business activities. The party making such an assertion must prove by clear and cogent evidence that the business activities do not reasonably warrant a finding that the business activities are related. To demonstrate that income from cash, cash equivalents, or short-term securities is derived from unrelated business activities, a taxpayer must prove by clear and cogent evidence that the underlying assets and their acquisition, maintenance, and management were, in fact, unrelated to the pass-through entity's business activities in the Commonwealth.

3. Presumption of Unrelated Business Activity of Pass-through Entity Limited Partners. In cases where a pass-through entity limited partner owns no more than 50% of the capital interests of a partnership, income that the pass-through entity limited partner derives from the holding or disposition of its limited partnership interest is presumed to be unrelated to the pass-through entity's other business activities unless the Commissioner or the taxpayer rebuts this presumption, as provided (and applicable) in 830 CMR 63.39.1(8)(f). If the business activities of the pass-through entity limited partner and the limited partnership are unrelated, then the pass-through entity limited partner must separately account for its limited partnership income and its other business income and must separately apportion to Massachusetts income from each unrelated activity (to the extent that Massachusetts has jurisdiction to tax income from each such activity), using only the apportionment factors applicable to that activity.

Example (6)(d)(3.1). Texas LLC owns a minority limited partnership interest in Partnership A. Partnership A conducts business in Massachusetts. Apart from this partnership holding, Texas LLC does not conduct business in Massachusetts. Texas LLC does conduct business in other jurisdictions, either directly or through ownership of other pass-through entities. Neither Texas LLC nor the Commissioner rebuts the presumption that the business activities of Texas LLC and Partnership A are unrelated. Texas LLC must separately apportion to Massachusetts income from the holding or disposition of its interest in Partnership A, using the apportionment factors derived from the partnership's activity. Income from Texas LLC's other activities is not subject to

Massachusetts tax jurisdiction and is excluded from the Massachusetts source income that it reports to its members.

(e) Special Apportionment Rules for the Gain on the Sale of an Ownership Interest in a Partnership that Holds Real Property in Massachusetts.

1. Partnerships that are Carrying on a Trade or Business in Massachusetts. A nonresident partner who sells an interest in a partnership that both holds an interest in real property in Massachusetts and is carrying on a trade or business in Massachusetts is subject to the general rule at 830 CMR 62.5A.1(3)(c)8., particularly as illustrated at 830 CMR 62.5A.1, Example (3)(c)(8.2).

2. Partnerships that are not Carrying on a Trade or Business in Massachusetts. A nonresident partner who sells an interest in a partnership that holds an interest in real property in Massachusetts but is not carrying on a trade or business in Massachusetts should apply the following rule. The non-resident partner selling his or her interest in the partnership must multiply the gain by a fraction, the numerator of which is the value of the Massachusetts real property and the denominator of which is the total value of the partnership. The value of real property to be used in the fraction is the current fair market value of the property reduced by the value of any lien or encumbrance remaining thereon at the time the partner sells his or her interest in the partnership.

Example (6)(e)(2). Non-resident is a partner in Land Hold, a partnership that purchases land in several states and holds the land for subsequent sale to developers. The partnership was formed with an initial capital contribution from its partners, but was not engaged in the conduct of a trade or business in Massachusetts during the year that Nonresident sells his interest in the partnership. The Massachusetts source income derived from the sale is the total gain from the sale, multiplied by fraction set forth in 830 CMR 62.5A.1(6)(e)(2).

#### 830 Mass. Code Regs. 63.39.1(7)(a) *Sourcing*

Except as provided by 830 CMR 63.39.1(7)(b), *infra*, a business corporation is subject to the excise under M.G.L. c. 63, §§ 2, 2A or 39, if the corporation is a general or limited partner in a partnership whose activities, if conducted directly by the business corporation, would subject that corporation to the corporate excise under the provisions of M.G.L. c. 63, §§ 2, 2A or 39. In the case of a tiered partnership arrangement the activities of the partnership(s) occupying the lower tier(s) are imputed to all partners holding interests in partnership(s) occupying higher tier(s). In applying this provision, the Commissioner will consider whether the assertion of jurisdiction is limited by the provisions of the U.S Constitution or federal law.

#### Massachusetts Department of Revenue Information on elective pass-through entity excise *PTE*

Several factors must be taken into account as illustrated by the following simplified example:

Partnership ABCD does business in MA with 50% apportionment  
Partnership net income for 2021 is \$1,000  
Partners A and B are Massachusetts resident individuals  
Partner C is a nonresident individual  
Partner D is a resident partnership  
Each partner is a 25% owner  
The PTE Excise would be calculated as follows:

Determine the partners subject to tax in Massachusetts under chapter 62. Here it would be partners A, B and C.

Determine the amount of taxable income allocable to each partner. Partners A and B each have \$250 of income ( $\$1,000 \times 25\%$ ). Partner C has \$125 of income. ( $\$1,000 \times 25\% \times 50\%$  apportionment). Total income subject to tax under chapter 62 =  $\$250 + \$250 + \$125 = \$625$ . Partner D is not a qualified member and its share of income is not taken into account under the PTE Excise.

Apply 5% PTE Excise rate to such income ( $\$625 \times 5\% = \$31.25$ ).

\*Note that in this example no PTE Excise is allocable to Partner D—the upper-tier PTE—regardless of the identity of the partners of Partner D. Its un-apportioned 25% of the \$1,000 income flows up to its own Form 3 return. Partner D may make its own election to be subject to the PTE Excise.

If a PTE makes an election to pay the PTE Excise, the entity's income is taxed at a rate of 5%, regardless of whether the income is Part A, B or C income under the Massachusetts personal income tax statute. The statutory rates that apply to each class of income must nevertheless, as relevant, be applied on the return of each qualified member.

## Massachusetts Department of Revenue Tax Guide for Pass-Through Entity Tax Withholding *Withholding/Return*

### **Definition of Tiered Structure**

A tiered structure is a pass-through entity that has at least one pass-through entity as a member.

The pass-through entity that is the member is the upper-tier entity. The entity of which it is a member is the lower-tier entity.

A tiered structure can have any number of tiers.

### **Pass-Through Member Compliance in a tiered structure**

The obligation to withhold begins with the lowest-tier entity that has Massachusetts-source income. Regarding its members that are pass-through entities, the lowest-tier entity must either:

- Obtain certifications of exemption or
- Withhold.

An upper-tier entity may have its own withholding obligation regarding Massachusetts-source income if its income hasn't previously been subject to withholding.

If an upper-tier entity has no Massachusetts-source income other than its distributive share of income from the lower-tier entity, the lower-tier entity's withholding will be sufficient to meet the upper-tier entity's withholding obligation.

Each upper-tier entity must pass information about amounts withheld to its own members.

### **Filing requirements**

A pass-through entity that derives income that is taxable in Massachusetts, whether from

- The conduct of a trade or business or
- The ownership of real or tangible personal property in Massachusetts,

must file a withholding return in Massachusetts, unless it is exempt as described above. Please refer to all current electronic filing requirements on the Department's website.

In a tiered structure, the distributive share of income that an upper-tier entity receives from a lower-tier entity, which derives income from Massachusetts sources is considered to be derived from Massachusetts sources. Accordingly, the upper-tier entity must file a Massachusetts withholding return.

The activities of a pass-through entity are attributed to its members. An upper-tier entity is therefore engaged in the activities of the lower-tier entity. This is true regardless of the number of tiers of pass-through entities between the lowest tier of the entity structure and the highest tier.

If the upper-tier entity certifies to the lower-tier entity that it will be filing its own withholding return in Massachusetts including any income from the lower-tier entity, the lower-tier entity won't be required to withhold on the upper-tier entity.

**An upper-tier entity may influence the lower-tier entity's withholding treatment if the upper tier entity:**

- Certifies to the lower-tier entity that it is tax-exempt under Internal Revenue Code section 501, and that all its distributive share from the lower-tier entity will be exempt from Massachusetts tax;
- Certifies to the lower-tier entity that because it will be filing its own return including any distributive share from the lower-tier entity, it is exempt from the withholding requirement;
- Certifies to the lower-tier entity that because all of its members are exempt from withholding, the lower-tier entity doesn't have to withhold on the upper-tier entity's distributive share (the upper-tier entity should be able to produce its members' exemption certificates at the Commissioner's request); or
- Communicates the names, addresses, and federal identification numbers or social security numbers of all the upper-tier's members to the lower-tier entity so that the lower-tier entity can withhold directly upon the upper-tier's members. The lower-tier entity may accept copies of exemption certificates filed with the upper-tier entity in lieu of withholding on those members. This arrangement is at the discretion of the lower-tier entity. Requests for such treatment are made on the withholding exemption certificate form, copies of which must be retained by both the upper-tier and lower-tier entities. The amount withheld must account for tax applied to the entire taxable distributive share transferred from the lower-tier entity to the upper-tier entity. The lower-tier entity must communicate amounts withheld to the upper-tier entity for inclusion on the members' Schedules 3K-1, 2K-1, and/or SK-1.

**Upper-tier entity obligations**

The upper-tier entity is responsible for allocating to its members the amount withheld on its behalf by the lower-tier entity. The sum of the withheld tax allocated to the upper-tier entity's members must equal the amount withheld on the upper-tier entity's distributive share from the lower-tier entity.

If the upper-tier entity has additional Massachusetts-source income, it may be required to withhold additional amounts, in accordance with Massachusetts withholding rules.

Amounts withheld by all lower tiers on behalf of a member for the taxable year must be summed and reported on the members' Schedule 3K-1, 2K-1, and/or SK-1.

**Special S-Corporation Rules**

A lower-tier entity that is an S-corporation must have the same tax year as any upper-tier entity for withholding purposes. Either:

- The upper-tier entity and the lower-tier S corporation must align their taxable years so that the lower-tier entity can withhold, or
- The upper-tier entity must certify that it will be filing its own return.

830 Mass. Code Regs. 62.5A.1(11)(F) *Withholding/Return*

1. General rule. A pass-through entity may file a composite return on behalf of qualified electing non-residents reporting and paying income tax on the non-residents' pro rata or distributive shares of Massachusetts source income of the pass-through entity.

a. Person responsible for filing. Each qualified electing non-resident member must give the pass-through entity a power of attorney authorizing a common member to act as the filing agent to represent the participating member in making, executing, and filing the return, and in acting on any matter relating to the return. The power of attorney shall include authorization of a successor to the filing agent. The filing agent must make the composite tax return using the pass-through entity's name and federal identification number, sign the composite tax return, and accept all notices from the Department of Revenue on behalf of any and all qualified electing non-residents.

b. Qualified electing non-residents. A non-resident who meets all of the following criteria is a qualified electing non-resident:

i. the person must be an individual, or an entity that is taxed under the Code as an individual, such as an electing small business trust (ESBT), or the estate or trust of a deceased non-resident;

ii. the person must be a non-resident for the entire tax year;

iii. the person must elect to be included in the composite return by signing, either as individual or as trustee, the statement required under 830 CMR 62.5A.1(11)(f)3; and

iv. the person must waive the right to claim deductions, exemptions, and credits allowable under M.G.L. c. 62, §§3, 5, and 6 on income reported on the composite return.

c. Tiered pass-through entities. To prevent multiple composite returns on the same income, an upper-tier pass-through entity that recognizes distributive share income is not required to file a composite return on non-resident member income generated by a lower-tier entity that the lower-tier entity has already reported on a composite return.

830 Mass. Code Regs. 62.5A.1(11)(G) *Withholding/Return*

A tiered group of pass-through entities (a pass-through entity with one or more members that are also pass-through entities) may file a single composite return on behalf of its non-resident members if each entity and individual taxpayer is otherwise eligible to participate in the filing of a composite return. The following additional requirements must also be met:

1. Each of the pass-through entities must join in the filing of a single composite return on behalf of its qualified electing non-residents, and the filing agent of each entity must sign the return.

2. A schedule must be submitted with the composite return indicating each qualified electing non-resident's distributive share of Massachusetts source income from each pass-through entity, and the total amount of Massachusetts source income received by each taxpayer from all the pass-through entities combined.

3. A statement must be submitted with the composite return disclosing the group's ownership structure, the identity of each member, (including name, address, and

federal identification number), the nature and extent of ownership interests, and the identity of each partner or member of all of the related entities from which participating non-residents directly or indirectly derive Massachusetts source income.

4. The return must indicate that it is a tiered entity composite return.

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## Michigan

### Mich. Comp. Laws § 206.661(2) *Sourcing*

The tax base of a taxpayer whose business activities are confined solely to this state shall be allocated to this state. The tax base of a taxpayer whose business activities are subject to tax both within and outside of this state shall be apportioned to this state by multiplying the tax base by the sales factor calculated under section 663. For a taxpayer that has a direct, or indirect through 1 or more other flow-through entities, ownership interest or beneficial interest in a flow-through entity, the taxpayer's business income that is directly attributable to the business activity of the flow-through entity shall be apportioned to this state using an apportionment factor determined under section 663 based on the business activity of the flow-through entity unless the flow-through entity is unitary with the taxpayer for apportionment purposes as provided under section 663.

### Mich. Comp. Laws § 206.663 *Sourcing*

- (1) Except as otherwise provided in subsection (2) and section 669, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year and the denominator of which is the total sales of the taxpayer everywhere during the tax year. The numerator of a taxpayer shall include its proportionate share of the total sales in this state of a flow-through entity that is unitary with the taxpayer. The denominator of a taxpayer shall include its proportionate share of the total sales everywhere of a flow-through entity that is unitary with the taxpayer. A flow-through entity is unitary with a taxpayer when that taxpayer owns or controls, directly or indirectly, more than 50% of the ownership interests with voting rights or ownership interests that confer comparable rights to voting rights of the flow-through entity, and that has business activities or operations which result in a flow of value between the taxpayer and the flow-through entity, or between the flow-through entity and another flow-through entity unitary with the taxpayer, or has business activities or operations that are integrated with, are dependent upon, or contribute to each other.
- (2) Except as otherwise provided under this subsection, for a taxpayer that is a unitary business group, sales include sales in this state of every person included in the unitary business group without regard to whether the person has nexus in this state. Sales between persons included in a unitary business group must be eliminated in calculating the sales factor. Sales between a taxpayer and a flow-through entity unitary with that taxpayer shall, to the extent of the taxpayer's interest in the flow-through entity, be eliminated in calculating the sales factor. Sales between a flow-through entity unitary with a taxpayer and another flow-through entity unitary with that same taxpayer shall, to the extent of the taxpayer's interest in the selling flow-through entity, be eliminated in calculating the sales factor.
- (3) It is the intent of the legislature that the tax base of a taxpayer is apportioned to this state by multiplying the tax base by the sales factor multiplied by 100% and that apportionment shall not be based on property, payroll, or any other factor notwithstanding section 1 of 1969 PA 343, MCL 205.581.

*Malpass v. Dep't of Treasury*, 833 N.W.2d 272 (Mich. 2013) *Sourcing*

The Michigan Supreme Court held “that the ITA does not prohibit individual taxpayers from combining the profits and losses from unitary flow-through businesses and then apportioning that income on the basis of the businesses’ combined apportionment factors. Moreover, we hold that the ITA did not limit apportionment of income to domestic businesses during the 1994 and 1995 tax years, and that the apportionment could properly be applied to a foreign entity to the extent that the foreign entity and the individual taxpayer’s in-state business were unitary.”

Mich. Comp. Laws § 206.815 *PTE*

(2) The business income tax base means a taxpayer’s business income subject to the following adjustments, before allocation or apportionment, and the adjustment in subsection (4) after allocation or apportionment . . .

(h) Deduct business income received as a member of another flow-through entity to the extent that the business income increased federal taxable income.

(3) For a taxpayer that has a direct, or indirect through 1 or more other flow-through entities, ownership or beneficial interest in a flow-through entity for which an election was made under section 813 and that reported positive business income in a tax year ending on or within the taxpayer’s tax year, the adjustments in subsection (2) shall not include the taxpayer’s share of the electing flow-through entities adjustments under subsection (2).

(4) For a taxpayer that has a direct, or indirect through 1 or more other flow-through entities, ownership or beneficial interest in a flow-through entity for which an election was not made under section 813, add the taxpayer’s share of the non-electing flow-through entity’s positive business income as determined under section 817(2).

(5) In computing the tax due under this part, the taxpayer shall pay the tax due only on the business income tax base allocable to those members who are individuals, flow-through entities, estates, or trusts and exclude the business income tax base allocable to those members that are corporations, insurance companies, or financial institutions. The department may require the taxpayer to disclose identifying information for all members of the taxpayer and the allocable share of business income for each member.

Michigan Flow-Through Entity Tax Frequently Asked Questions *PTE*

**What is a tiered or indirect credit?**

These terms can be used to describe a credit generated by an FTE taxpayer for another flow-through entity, which is listed as a direct member on Form 5774, Part 2. That credit is passed through to the member flow-through entity’s owners and each respective share is ultimately claimed by taxpayers subject to Michigan individual income tax or corporate income tax (Part 1 or Part 2 of the Michigan Income Tax Act). Those taxpayers own the credit-generating flow-through entity indirectly, which is why their credits may be referred to as indirect credits. In addition, this ownership structure is often referred to as a tiered structure and therefore, creates what may be referred to as tiered credits.

**What support must be provided to a member to support their claim of an indirect or tiered credit?**

Documentation provided to a member to report that member’s share of FTE tax credit and tax base adjustments must include the name and FEIN of the credit-generating flow-through entity, and have credits and adjustments separately stated by flow-through entity. For more information about the required reporting to members, see Section I.E. of Treasury’s Notice Regarding the Implementation of the Michigan Flow-Through Entity Tax. Importantly, these specific reporting requirements apply to both

electing and non-electing flow-through entities within a tiered structure in order to allow the ultimate member to claim the credit and make any return adjustments as necessary.

Michigan Revenue Administrative Bulletin 2010-8 (November 5, 2010) *Withholding/Return*

A flow-through entity that has one or more members who are other flow-through entities is categorized as a tiered entity. A typical tiered entity structure consists of a source, or lower tier, flow-through entity, and one or more pass through, or upper tier, entities. In this type of arrangement, the upper tier entity receives income from the lower tier entity that it passes through to its own members.

When a lower tier flow-through entity files a composite return on behalf of its nonresident members, an upper tier flow-through entity may elect to participate in the composite filing, together with the lower tier entity's other nonresident members. If the upper tier entity has no other source of Michigan income, this composite filing will fulfill its Michigan income tax filing requirement. If the upper tier entity's members have no Michigan sourced income, the lower tier's composite filing fulfills their Michigan income tax filing and payment obligations as well.

When the upper tier elects to participate in the lower tier's composite filing, the upper tier's share of income and withholding tax payments from the lower tier entity are reported on the composite return filed by the lower tier. If the upper tier entity has other Michigan sourced income, and files its own composite return on behalf of its own nonresident members, its share of income from the lower tier entity is subtracted on the (upper tier's) composite return. Therefore, the withholding payments made on its behalf by the lower tier entity are not included on the upper tier entity's composite return when it participates in the lower tier's composite filing.

When the upper tier entity does not participate in a composite filing made by the lower tier, or the lower tier does not file a composite return, then the upper tier entity reports its income from the lower tier entity, and claims any withholding tax payments made on its behalf by the lower tier entity, on the (upper tier entity's) composite return. The lower tier may not include withholding payments made on behalf of a nonparticipating upper tier entity or any other nonparticipants on its own composite return. The upper tier entity will subtract its share of income from the lower tier entity as income from other partnerships, S corporations, and fiduciaries included in ordinary income on line 36 of the composite return, but then add back the Michigan portion of the lower tier entity's income as income attributed to other Michigan partnerships, S corporations, or fiduciaries that have not been reported on another composite return on line 40 of the composite return. Therefore, the withholding payments made on its behalf by the lower tier entity are included on the upper tier entity's composite return when it does not participate in the lower tier's composite filing.

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## Minnesota

### Minn. Stat. § 290.014 *Sourcing*

Subd. 4: Except as provided in section 290.015, a partnership is subject to the return filing requirements and to tax as provided in this chapter if the income of the partnership is:

- (1) allocable to this state under section 290.17, 290.191, or 290.20;
- (2) taxed to the partnership under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary of an estate with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account



the income character provisions of section 662(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the partnership directly from the source from which realized by the estate;

(3) taxed to the partnership under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary or grantor or other person treated as a substantial owner of a trust with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 652(b), 662(b), or 664(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the partnership directly from the source from which realized by the trust; or

(4) taxed to the partnership under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a limited or general partner in a partnership with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 702(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the second tier partnership directly from the source from which realized by the first tier partnership.

Subd. 5: Except as provided in section 290.015, corporations are subject to the return filing requirements and to tax as provided in this chapter if the corporation so exercises its franchise as to engage in such contacts with this state as to cause part of the income of the corporation to be:

(1) allocable to this state under section 290.17, 290.191, 290.20, or 290.36;

(2) taxed to the corporation under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary of an estate with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 662(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the corporation directly from the source from which realized by the estate;

(3) taxed to the corporation under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a beneficiary or grantor or other person treated as a substantial owner of a trust with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 652(b), 662(b), or 664(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the corporation directly from the source from which realized by the trust; or

(4) taxed to the corporation under the Internal Revenue Code (or not taxed under the Internal Revenue Code by reason of its character but of a character which is taxable under this chapter) in its capacity as a limited or general partner in a partnership with income allocable to this state under section 290.17, 290.191, or 290.20 and the income, taking into account the income character provisions of section 702(b) of the Internal Revenue Code, would be allocable to this state under section 290.17, 290.191, or 290.20 if realized by the corporation directly from the source from which realized by the partnership.

Minn. Stat. § 290.17 *Sourcing*

Subd. 1(a) The income of resident individuals is not subject to allocation outside this state. The allocation rules apply to nonresident individuals, estates, trusts, nonresident partners of partnerships, nonresident shareholders of corporations treated as "S" corporations under section 290.9725, and all corporations not having such an election in effect. If a partnership or corporation would not otherwise be subject to the allocation rules, but conducts a trade or business that is part of a unitary business involving another legal entity that is subject to the allocation rules, the partnership or corporation is subject to the allocation rules.

Subd 4(b) The term "unitary business" means business activities or operations which result in a flow of value between them. The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a sole proprietorship, a corporation, a partnership or a trust.

Subd 4(g) For purposes of determining the net income of a unitary business and the factors to be used in the apportionment of net income pursuant to section 290.191 or 290.20, there must be included only the income and apportionment factors of domestic corporations or other domestic entities that are determined to be part of the unitary business pursuant to this subdivision, notwithstanding that foreign corporations or other foreign entities might be included in the unitary business; except that the income and apportionment factors of a foreign entity, other than an entity treated as a C corporation for federal income tax purposes, that is included in the federal taxable income, as defined in section 63 of the Internal Revenue Code as amended through the date named in section 290.01, subdivision 19, of a domestic corporation, domestic entity, or individual must be included in determining net income and the factors to be used in the apportionment of net income pursuant to section 290.191 or 290.20.

*Minn. Stat. § 290.0922, subd. 4 (Minimum Fee) Sourcing*

For the purposes of this section, a partner's pro rata share of a partnership's property, payroll, and sales or receipts is not included in the property, payroll, and sales or receipts of the partner.

*Minnesota Revenue Notice 08-03 (February 19, 2008) Sourcing*

Partnership income is included in the corporate partner's Minnesota income in one of two ways.

Partnership income is subject to apportionment as business income of the unitary business when a unitary business relationship exists between the corporation and the partnership. The determination of the existence of a unitary business must be made under Minnesota Statutes, section 290.17, subdivision 4, except that a corporation need not own more than 50% direct ownership in the partnership to be included in the unitary business. When a corporation and a partnership are engaged in a unitary business, the corporation must include its partnership income in its apportionable business income. The corporation must also include its pro-rata share of the partnership's property, payroll, and sales/receipts located within and outside Minnesota in the corporation's property, payroll, and sales/receipts numerator and denominator.

If the corporation and partnership are not engaged in a unitary business, the corporation must report its partnership income or loss as separately stated income or loss. If the partnership's business is conducted wholly within Minnesota, the corporate partner's share of partnership income or loss must be assigned entirely to Minnesota by the corporate partner. If the partnership business is conducted wholly outside Minnesota, the corporate partner's share of partnership income or loss must be assigned entirely outside Minnesota. If the partnership conducts its business both within and without Minnesota, the corporate partner's share of partnership income or loss is assigned to

Minnesota based on the partnership's property, payroll, and sales/receipts apportionment factors.

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## Mississippi

### Miss. Code Ann. § 27-7-23(b)(2) *Sourcing*

Income derived from trade, business or other commercial activity shall be taxed to the extent that it is derived from such activity within this state. Mississippi net income shall be determined in the manner prescribed by the commissioner for the allocation and/or apportionment of income of foreign corporations having income from sources both within and without the state.

### Miss. Code Ann. § 27-7-23(2)(2)(A) *Sourcing*

Except as provided in Sections 27-7-24, 27-7-24.1, 27-7-24.3, 27-7-24.5, 27-7-24.7, 27-7-24.8 and 27-7-24.9, Mississippi Code of 1972, any corporation or organization having business income from business activity which is taxable both within and without this state shall allocate and apportion its net business income as prescribed by regulations enacted by the commissioner. If the business income of the corporation is derived solely from property owned or business done in this state and the corporation is not taxable in another state, the entire business income shall be allocated to this state. A corporation is taxable in another state if, in that state the corporation is subject to a net income tax, or a franchise tax measured by net income, or if that state has jurisdiction to subject the corporation to a net income tax regardless of whether the state does or does not subject the corporation to a net income tax

### tit. no. 35 - pt. 3, subpt. 08, ch. 06, Miss. Code R. 302.01(8) *Sourcing*

Royalty income from mineral production must be allocated to the state where production occurred. Partnership income is allocated directly to the state where the partnership gross income or loss occurred.

### tit. no. 35 - pt. 3, subpt. 08, ch. 06, Miss. Code R. § 401.04 *Sourcing*

If the business activity in respect to any trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer in another state, portion of the net income (or net loss) arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with the further provisions of this regulation, where direct or separate accounting of net income or loss is not feasible.

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## Missouri

### Mo. Rev. Stat. § 143.421 *Sourcing*

- (1) In determining the adjusted gross income of a nonresident partner of any partnership, there shall be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss, and deduction entering into his federal adjusted gross income, as such part is determined under regulations prescribed by the director of revenue in accordance with the general rules in section 143.181 . . .
- (4) The director of revenue may, on application, authorize the use of such other methods of determining a nonresident partner's portion of partnership items derived

from or connected with sources in this state, and the modifications related thereto, as may be appropriate and equitable, on such terms and conditions as he may require.

Mo Rev. Stat. § 143.411(2) *Sourcing*

Each item of partnership income, gain, loss, or deduction shall have the same character for a partner under sections 143.005 to 143.998 as it has for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Mo. Code Regs. Ann. tit. 12, § 10-2.190(2)(B) *Sourcing*

The partnership return or S corporation return shall reflect the total income of the partnership or S corporation from all sources and allocate to Missouri that portion of the total income which is derived from or connected with sources in Missouri by using the apportionment formula in sections 32.200 or 143.451, RSMo. The ratio with a numerator of that portion of the total income which is derived from or connected with sources in Missouri and a denominator of the total income of the partnership or S corporation shall be the basis of allocation of each nonresident partner's or nonresident shareholder's income to Missouri by applying that percentage to the total distributable income of each nonresident partner or shareholder based upon his/her percentage of interest in the partnership or S corporation.

Missouri Private Letter Ruling No. LR 4970 (08/05/2008) *Sourcing*

By statutory definition, to be a partnership in Missouri, the entity has to be carrying on a business. Here, the Partnership's trade or business is investing in securities such as stocks, mutual funds, bonds and other investments, even if it has a contractual relationship with a bank to do so. The Partnership incurs income from carrying on its trade or business of investing in Missouri. This income is thus Missouri source income. Because a partnership is a flow-through entity, partners are deemed to be carrying on the trade or business of the partnership. Therefore, income from the Partnership's trade, investing, is Missouri source income for the partners, including Applicant.

Here, Applicant is a nonresident and general partner in the Partnership. As a general partner, Applicant is deemed to be in the Partnership's trade or business. The income Applicant received as a partner is income derived from sources within this state, is attributable to a business carried on in this state, and is thus Missouri source income.

Missouri Private Letter Ruling No. LR 2664 (12/21/2000) *Sourcing*

Applicant is based in Texas. Applicant is a limited partner in a limited partnership (Limited Partnership A), which in turn is a limited partner in another limited partnership (Limited Partnership B), which owns an interest in a hotel in Missouri. Over 99% of Applicant's income comes from Limited Partnership A, which does no business in Missouri. Different general partners manage Limited Partnership A and Limited Partnership B, and none of the general partners are located in Missouri.

ISSUE:

May Applicant apportion income to Missouri based on the actual amount of income generated in Missouri?

RESPONSE:

Applicant may not apportion income to Missouri based on the actual amount of income generated in Missouri.

The use of an apportionment formula within a special method that is predicated upon separate accounting is an inherent conflict of theories. Applicant states in its letter that over 99 percent of Applicant's income comes from Limited Partnership A, which does no business in Missouri. While on the surface, this contention makes separate accounting seem very reasonable, experience shows that the application of standard formula apportionment methods on a consistent year-in-year-out basis not only results in the fairest long-term treatment of a taxpayer, but results in the most equitable apportionment of the tax burden among the various taxpayers doing business within Missouri and other states.

#### Missouri Department of Revenue Partnership Tax FAQ *Sourcing*

##### **What is considered Missouri source income?**

Items of income, gain, loss and deduction derived from, or connected with, sources within Missouri are those items attributable to (1) the ownership or disposition of any interests in real or tangible personal property in Missouri or (2) a business, trade, profession or occupation carried on in Missouri. Income from intangible personal property, to the extent that such property is employed in a business, trade, profession or occupation carried on in Missouri, constitutes income derived from sources within Missouri.

#### Mo Rev. Stat. § 143.436 *PTE*

- (5) If an affected business entity is a direct or indirect member of another affected business entity, the member affected business entity shall, when calculating its net income or loss pursuant to subsection\* 3 or 4 of this section, subtract its distributive share of income or add its distributive share of loss from the affected business entity in which it is a direct or indirect member to the extent that the income or loss was derived from or connected with sources within this state, as determined pursuant to section 143.455.
- (7) Each partnership and S corporation shall report to each of its members, for each tax year, such member's direct pro rata share of the tax imposed pursuant to this section on such partnership or S corporation if it is an affected business entity and its indirect pro rata share of the tax imposed on any affected business entity in which such affected business entity is a direct or indirect member.
- (8) (1) Each member that is subject to the tax imposed pursuant to section [143.011](#) shall be entitled to a credit against the tax imposed pursuant to section [143.011](#). Such credit shall be in an amount equal to such member's direct and indirect pro rata share of the tax paid pursuant to this section by any affected business entity of which such member is directly or indirectly a member. . .
- (10) (1) Each corporation that is subject to the tax imposed pursuant to section 143.071 and that is a member shall be entitled to a credit against the tax imposed pursuant to section 143.071. Such credit shall be in an amount equal to such corporation's direct and indirect pro rata share of the tax paid pursuant to this section by any affected business entity of which such corporation is directly or indirectly a member. Such credit shall be applied after all other credits.

#### Form MO-PTE Instructions (2022) *PTE*

If the affected business entity completing this Form MO-PTE is a direct or indirect member of another affected business entity, such other affected business entity is referred to as an lower-tier affected business entity. The affected business entity completing this Form MO-PTE must add together its share(s) of Missouri net income or Missouri net loss from all lower-tier affected business entities. If this sum is negative, enter a negative figure on Line 7. Attach a copy of the Missouri pass-through entity tax reports sent

to the affected business entity completing this Form MO-PTE from all lower-tier affected business entities pertaining to this tax year

Missouri Department of Revenue Partnership Tax FAQ *Withholding/Return*

### **Who can be included in a composite return?**

Any nonresident partner, including corporations, trust, partnerships, and estates not otherwise required to file a Missouri income tax return.

Missouri Private Letter Ruling No. LR 4110 (10/01/2007) *Withholding/Return*

Based on these facts, Applicant should file one aggregate composite income tax return with the state of Missouri on behalf of all of its non-resident owners, including other flow through entities. The 4 C Corporations filing separate corporation income tax returns are properly excluded from the Applicant's composite return. Statutory authority for resident partner modifications, nonresident partners, composite returns, and the withholding that is required is provided for in Section 143.411. RSMo. Specifically, Section 143.411.4 provides:

The director of revenue shall permit partnerships to file composite returns and to make composite payments of tax on behalf of its nonresident partners not otherwise required to file a return. If the nonresident partner's filing requirements result solely from one or more interests in any other partnerships or subchapter S corporations, that nonresident partner may be included in the composite return.

A composite return is allowed by the department for any partnership, S corporation, limited liability partnership or limited liability company (treated as a partnership for tax purposes) with nonresident partners or S corporation shareholders not otherwise required to file a Missouri individual income tax return. Nonresident individuals, partnerships, S corporations, regular corporations, estates (filing a Federal Form 1041) and trusts can be included on the composite income tax form. So long as all of Applicant's nonresident partners, including other flow-through entities (e.g. partnerships, limited liability companies, trusts, etc.) and upper tier individual partners are not otherwise required to file a Missouri state income tax return, they may be included in one aggregate composite return filed by the Applicant. Applicant's composite returns must be filed on the individual income tax long form (Form MO-1040).

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## Montana

Mont. Code Ann. § 15-30-3302 *Sourcing*

(2) Except as otherwise provided, each partner of a partnership described in subsection (1)(a), each shareholder of an S. corporation described in subsection (1)(b), and each partner, shareholder, member, or other owner of an entity described in subsection (1)(c), the first-tier pass-through entity, is subject to the taxes provided in this chapter, if an individual, trust, or estate, and to the taxes provided in Title 15, chapter 31, if a C. corporation. If a partner, shareholder, member, or other owner of an entity described in subsection (1) is itself a pass-through entity, any individual, trust, or estate to which the first-tier pass-through entity's Montana source income is directly or indirectly passed through is subject to the taxes provided in this chapter and any C. corporation to which the first-tier pass-through entity's Montana source income is directly or indirectly passed through is subject to the taxes provided in Title 15, chapter 31 . . .

(6) For purposes of this part:

(a) a partnership or S. corporation with business activity occurring both within and outside of this state shall calculate its Montana source income pursuant to the allocation and apportionment provisions contained in Title 15, chapter 31, part 3; and

(b) a disregarded entity that is not owned by an individual, estate, or trust and that has business activity occurring both within and outside of this state shall calculate its Montana source income pursuant to the allocation and apportionment provisions contained in Title 15, chapter 31, part 3.

Mont. Admin. R. 42.9.107 *Sourcing*

(1) A pass-through entity may have, in addition to income from its own operations or activities, income from one or more other pass-through entities. This rule describes how the pass-through entity must classify its income from its own operations or activities as apportionable or nonapportionable income and how it must report its income from other pass-through entities. For purposes of this rule, "operations income" means the income of a pass-through entity from its own operations or activities and "flow-through income" means its separately and nonseparately stated distributable share of income from other pass-through entities.

(2) Except as provided in (5), each pass-through entity has to separately determine whether its operations income is apportionable or nonapportionable income as those terms are defined in ARM 42.26.206. Once a pass-through entity determines the apportionable or nonapportionable character of its operations income, the entity must then determine what part of this apportionable and/or nonapportionable income is Montana source income. Except as provided in (5) and (6), the operations income retains its character as apportionable or nonapportionable income and as Montana source income regardless of how many other tiers of pass-through entities through which the income is passed.

(3) Except as provided in (5) and (6), flow-through income of a pass-through entity, determined as provided in (1), retains its character as apportionable and/or nonapportionable income and its character as Montana source income.

(4) An entity in a multi-tiered pass-through entity structure may have flow-through income sourced to Montana under the subsections of the definition of "Montana source income" in 15-30-2101, MCA, that address partnership or S corporation income derived from Montana activity or property, reportable on Montana Schedule K-1, and also operations income sourced to Montana as a result of its own business activity under other subsections of that definition of "Montana source income," such as net income from a business, profession, or farming activities carried on in the state. If this occurs the entity must allocate to Montana the flow-through income sourced to Montana and the entity must determine the portion of its operations income that is sourced to Montana as provided in (1) and allocate or apportion that Montana source income under the provisions of ARM 42.9.112.

(5) This rule does not apply to a partnership or disregarded entity whose operations are unitary with the business operations of a corporate partner or disregarded entity owner that is a C corporation whose apportionment factors are included in the computation of the C corporation's apportionment factors as provided in ARM 42.26.228.

(6) Nothing in this rule prevents the department from determining the apportionable or nonapportionable character of an entity's operations income or the Montana source character of its Montana flow-through income sourced to Montana.

Mont. Admin. R. 42.9.112(5) *Sourcing*

A partnership whose operations are unitary with the business operations of a direct or indirect corporate partner and whose apportionment factors are included in the computation of that corporate partner's apportionment factors, pursuant to ARM 42.26.228, are considered a part of the corporate group for the purpose of applying the Finnigan Rule described in ARM 42.26.260.

Mont. Admin. R. 42.26.228 *Sourcing*

(1) If the operations of a partnership or disregarded entity are unitary with the business operations of a corporate partner or disregarded entity owner, the corporate partner's or owner's pro rata share of the property, payroll, and sales of the partnership or disregarded entity will be included in the computation of the apportionment factors.

(2) The definition of unitary will be the same as the definition of a unitary business as outlined in 15-31-301, MCA. However, the corporate partner or disregarded entity owner need not own in excess of 50% of the partnership or disregarded entity for the partnership or disregarded entity to be unitary.

Mont. Admin. R. 42.26.229 *Sourcing*

A partnership or disregarded entity that is not part of a unitary business operation of a corporate partner or disregarded entity owner will be treated as follows:

(a) The corporate partner's or disregarded entity owner's share of partnership or disregarded entity income will not be included in apportionable income to be apportioned, but allocated to the states where the partnership or disregarded entity operates based upon the apportionment formula outlined in 15-31-305, MCA.

Mont. Code Ann. § 15-30-3336(3) *PTE*

The entity tax is in lieu of the tax paid under 15-30-3312 and 15-30-3313. If the owner of an electing pass-through entity is a partnership or S. corporation that does not elect to pay the entity tax, any amount of Montana source income in addition to the income subject to the entity tax is subject to the tax paid under 15-30-3313. When the provisions under 15-30-3313 apply, the withholding threshold under 15-30-3313(1) must be determined without regard to the entity tax.

Montana Form PTE Instructions (2023) *PTE*

Next, flow-through payments received from a lower tier, which are reported on the Flow-Through Payments Schedule, are applied to pass-through entity tax, composite tax, and pass-through withholding.

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## Nebraska

Neb. Rev. Stat. § 77-2728 *Sourcing*

Each item of partnership income, gain, loss, or deduction shall have the same character for a partner under the provisions of the Nebraska Revenue Act of 1967 as it has for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

316 Neb. Admin. Code § 24-301 *Sourcing*



### 301.01 In General

A business entity or unitary group generating income from a business activity that is taxable within Nebraska and subject to tax in at least one other state must apportion its income. The income is apportioned using the sales factor only, as provided in Reg-24-301 through Reg-24-350.

### 301.02 Apportionable Income

The entire federal taxable income of a corporation, a unitary group, or a partnership is presumed to be apportionable income. The apportionable income includes income arising from transactions and activity of the business, and income arising from tangible and intangible property if the acquisition, management, employment, development, or disposition of the property was related to the operation of the business entity's trade or business.

## 316 Neb. Admin. Code § 24-305 *Sourcing*

### 305.01 Corporations or Partnerships; Apportionment Formula

The federal taxable income, as adjusted under Reg-24-155, Nebraska Adjustments to Taxable Income, of a corporation or partnership operating both within and outside Nebraska is apportioned to Nebraska by using the sales factor of the corporation or partnership. The income of the taxpayer apportioned to Nebraska is determined by calculating the ratio of the taxpayer's sales in Nebraska compared to the total sales of the taxpayer and applying the computed ratio to the federal taxable income, as adjusted, of the taxpayer.

## 316 Neb. Admin. Code § 24-315 *Sourcing*

315.01 A business entity which is required to apportion income and has income from a partnership or joint venture (partnership), will calculate its Nebraska sales factor under this regulation. The entire federal taxable income of a corporate taxpayer is subject to apportionment in this state. Nebraska apportionable income includes any income or loss received due to a business entity's interest in a partnership. If neither the corporation nor the partnership is subject to tax in another state, the entire federal taxable income of the business entity is subject to Nebraska tax and will not be apportioned.

315.02 When a business entity is an owner in a partnership, the business entity's apportionment factor must be calculated based on whether or not the business entity and partnership are considered unitary. A unitary determination must be made for each business entity.

315.02A When a partnership has sufficient contacts with a business entity to be considered unitary if it were a corporation, the partnership will be considered unitary with the business entity regardless of the ownership share of the business entity.

315.02A(1) When a business entity and a partnership are considered unitary, the sales factor of the business entity must include the business entity's share of the partnership's sales determined by multiplying the partnership's sales factor numerator and denominator by the business entity's ownership percentage.

315.02A(2) Intercompany sales will be eliminated using calculations made in the following order:

315.02A(2)(a) Intercompany sales will be eliminated based on the percentage of the business entity's ownership of the partnership; except that sales from the partnership to the business entity or members of the unitary group will be eliminated only to the extent of the business entity's or unitary group's share of total sales of the partnership (See Reg-24-315.02A(4)); and

315.02A(2)(b) If all of the sales from the partnership to the business entity or unitary group are not eliminated based on Reg-24-315.02A(2)(a), the remaining sales in each state will be the same percentage of the sales in the state before any eliminations. (See Reg-24-315.02A(6))

315.02A(2)(c) Any partnership agreements that identify particular activities to a specific owner will not be considered when determining the income of each owner subject to tax in Nebraska . . .

315.02B When a partnership does not have sufficient contacts with a business entity to be considered unitary, the business entity's sales factor must include its share of income from the partnership. The net income distributed from the partnership to the business entity will be included in the denominator and the Nebraska source net income distributed from the partnership to the business entity will be included in the numerator . . .

315.02B(2) The business entity's sales factor does not include sales made by the partnership. Therefore, the business entity's sales factor is not adjusted to eliminate sales made between the business entity and the partnership.

#### Nebraska Return of Partnership Instructions (2022) *Sourcing*

Nebraska source income is determined by apportioning the partnership or LLC income using a single, sales-only factor. Apportionment refers to the division of income between states by the use of a formula containing one or more apportionment factors . . . For partnerships that are only subject to income tax in Nebraska, the amounts entered on lines 1-14 will come directly from the partner's Federal Schedule K-1. For partnerships that are subject to income tax in another state, the amounts entered on lines 1-14 will be the result of the Federal Schedule K-1 amounts multiplied by the partnership's Nebraska apportionment factor.

#### Neb. Rev. Stat. § 77-2727(6)(g)(iii) *PTE*

If a partnership making the election under this subsection is a partner of another electing partnership, net income shall be computed as provided in subsection (1) of this section. The upper tier electing partnership shall claim a credit for the tax paid by the lower tier electing partnership. The upper tier electing partnership shall distribute out the pro rata or distributive share of the credits to its partners for tax paid under this subsection by all tiers of electing partnerships. As used in this subdivision, the term lower tier electing partnership means an electing partnership in which some or all of the partners are an electing partnership. The term upper tier electing partnership means an electing partnership that is a partner of a lower tier electing partnership. An electing partnership may have two or more tiers.

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### New Hampshire

#### N.H. Rev. Stat. Ann. § 77-A:3(III) *Sourcing*

When 2 or more related business organizations are engaged in a unitary business, as defined in RSA 77-A:1, XIV, a part of which is conducted in this state by one or more members of the group, the income attributable to this state shall be determined by means of the applicable combined apportionment factors of the unitary business group in accordance with paragraphs I and II.

#### New Hampshire Department of Revenue Website *Sourcing*

For taxable periods ending on or after December 31, 2023, a 7.5% tax is assessed on income from conducting business activity within the State of New Hampshire. For taxable periods ending on or after December 31, 2022, a business organization deriving gross business profits from business activity both within and outside of the State shall apportion gross business profits using the single sales factor. Organizations operating a unitary business must use combined reporting in filing their New Hampshire business tax return.

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## New Jersey

### N.J. Admin. Code § 18:35-1.3(d)(6) *Sourcing*

A tiered partnership shall take into account its distributive share of partnership income from any partnership of which it is a member. Once income has been allocated by a partnership, it shall not be reallocated by the partners.

### N.J. Admin. Code § 18:7-7.6 *Sourcing*

(g) For purposes of apportionment (allocation) of corporate income, where the subject corporation and the partnership are not part of a single unitary business, including a business carried on directly by the foreign corporate partner, separate accounting apportionment should be used to arrive at corporate income. If the New Jersey business of the partnership is part of a single unitary business including a business carried on directly by the foreign corporate partner, flow through accounting apportionment should be used with respect to the incomes of the two entities.

(1) Separate accounting apportionment, for purposes of this subsection only, means use of the following method: The corporation's distributive share of the partnership's business income would be apportioned to New Jersey by computing the applicable N.J.S.A. 54:10A-6 apportionment factor for that business by only taking into account the corporate partner's share of the receipts of the business that the partnership carries on directly. Second, the corporation's entire net income, excluding its distributive share of the partnership's income is apportioned to New Jersey by computing the applicable N.J.S.A. 54:10A-6 apportionment factor for that business by only taking into account the receipts (excluding receipts from the partnership namely, receipts from intercompany transactions) of the business that the corporation carries on directly. Third, these two amounts would be added together to arrive at the corporation's entire net income apportioned to New Jersey.

(2) "Flow through accounting apportionment," for the purpose of this section only, means use of the following method: Taxpayer shall separately compute the receipts fractions attributable to the partnership activity. The taxpayer next computes the receipts fractions attributable to the corporate activity. An allocation factor combining the factors of the corporation and the partnership is then applied to the corporation's entire net income including its distributive share of the partnership's income.

(3) Facts that either singly or in combination may suggest that the corporation and partnership are part of a unitary business and hence that a flow through approach may be appropriate include, without limitation thereto:

- i. Substantial intercompany-partnership transactions;
- ii. The partnership interest is the only or the most substantial asset of the corporation;
- iii. The partnership interest produces all or most of the income of the corporation;
- iv. The corporation and the partnership are in the same line of business;

v. There is substantial overlapping of employees and offices; and/or

vi. There is sharing of operational facilities, technology, and/or know-how.

(4) For further information about combined returns and unitary businesses, see N.J.A.C. 18:7-21.

(h) The accounting methods described at (g) above are also applied to domestic corporate partners. If a domestic corporation is a partner in a foreign partnership that does not conduct business in New Jersey, and the corporation's own business and that of the partnership are not unitary, then the corporation's income from the partnership shall not be included in the corporation's tax base, and the partnership's receipts, payroll, and property shall not be considered in determining the apportionment factor to apply to the corporation's income from its own business. If, however, the two businesses are unitary, then the flow through method should be used in apportioning the corporation's income. For further information about combined returns and unitary businesses, see N.J.A.C. 18:7-21 .

(1) Solely for purposes of this section, each regular place of business of a partnership that is unitary with a corporate partner is to be treated as a regular place of business of the corporate partner. Relief pursuant to N.J.A.C. 18:7-8.3 is permitted to domestic partners with respect to partnership income duplicated on a return of a domestic corporate partner filed with another state. By virtue of its subjectivity under the Corporation Business Tax Act, a corporate partner may seek relief under N.J.S.A. 54:10A-8 if the taxpayer believes that tax computed does not result in a fair apportionment.

(i) A "tiered partnership," for the purposes of this section, is a partnership whose partners are partnerships. A corporation that is a partner in a partnership that in turn is a partner in yet another partnership is not immune from New Jersey taxation simply because of the tiered partnership. The ultimate tax burden and loss benefit falls on the corporate partner. The corporation shall file a New Jersey corporation business tax return taking account of its ultimate distributive share of the tiered partnership's income or loss from New Jersey activities.

(j) The classification of partnership items of income, expense, or loss as operational or nonoperational is to be determined in accordance with N.J.S.A. 54:10A-6.1. Whether or not a partnership is unitary or nonunitary with its corporate partner is a different issue from the issue of taxability of operational or nonoperational income or the deductibility of operational or nonoperational expenses or losses.

N.J. Stat. Ann. § 54A:12-5 *PTE*

(a)(5) a member that is an entity classified as a partnership for federal tax purposes shall be allowed (a) a refundable credit against the tax imposed under the "New Jersey Gross Income Tax Act," N.J.S. 54A:1-1 et seq., which credit shall be allocated among the partners of the partnership, or (b) a refundable credit against the tax liability of the partnership, which credit may be applied against:

(i) the tax imposed pursuant to of P.L. 2002, c. 40(C.54:10A-15.11);

(ii) the fee imposed pursuant to N.J.S. 54A:8-6; or

(iii) the tax imposed pursuant to of P.L. 2019, c. 320(C.54A:12-3).

(b) The credit allowed by this section shall be available after the application of all other credits allowed by law and claimed by the member, or as applicable, the beneficiary of a member estate or trust, the shareholder of a member corporation, or the partner of a member partnership, in the taxable year.

**A pass-through entity is owned by a corporation, part of the unitary business of the combined group, and the corporation is included as a member of a combined group. Is that pass-through entity which elects to pay the Pass-Through Business Alternative Income Tax included in the combined group?**

The pass-through entity is not a member of the combined group. The corporation is a corporate member of the pass-through entity and is a member of the combined group. The pass-through entity's attributes will flow-through to the corporation that is the member of the pass-through entity and will be included in the entire net income of the corporation and that of the combined group, and its receipts will be included in the combined group denominator and the corporation's numerator of the allocation factor. The corporation is entitled to a credit under N.J.S.A. 54:10A-5.43 that is shareable with the other members of the combined group.

**How does a New Jersey S corporation that is a partner in a tiered partnership claim a credit?**

For Tax Years 2020 and 2021, if a New Jersey S corporation is a partner in a tiered partnership, the New Jersey S corporation can only claim a credit for the amount of tax paid by the pass-through entity on its share of distributive proceeds on Form CBT-100S. The credit will not flow directly through to the S corporation's shareholder. However, the recent revisions to the BAIT law changes the treatment for tax years beginning January 1, 2022, and after. For Tax Year 2022, an S corporation can continue to claim credit for the amount of tax paid as a credit on its Form CBT-100S (which is now refundable) or it can choose to either allocate its share of the Pass-Through Business Alternative Income Tax to its own individual, estate, or trust shareholders without having to make a BAIT election or it can claim credit for the amount of tax paid as a credit on its own Form PTE-100.

**How will the Pass-Through Business Alternative Income Tax apply for tiered partnerships?**

For Tax Years 2020 and 2021, a tiered partnership can only claim a credit for the amount of tax paid by the pass-through entity on its share of distributive proceeds on Form NJ-CBT-1065. The credit will not flow directly through to the tiered partnership's partners.

For tax year 2022, a partnership can continue to claim credit for the amount of tax paid on its Form NJ-CBT-1065 or it can choose to allocate its share of the Pass-Through Business Alternative Income Tax to its own individual, estate or trust partners without having to make a BAIT election; claim credit for the amount of tax paid on its share of distributive proceeds on Form NJ-1065 or claim it as a credit on its own Form PTE-100.

Note: If a New Jersey S corporation is a partner in a tiered partnership, refer to the tiered partnership question in the Corporations section.

*NJ-CBT-1065 Instructions (2022) Withholding/Return*

Schedule T, Tiered Partnership Payment Schedule, if the entity is claiming (1) credit for tax remitted on its behalf by another entity or (2) its share of Pass-Through Business Alternative Income Tax. The Name, Federal EIN, Share of New Jersey Tax reported on line 1 of Part III of each Schedule NJK-1, and Share of Pass-Through Business Alternative Income Tax reported on each Schedule PTE-K-1 must be reported. Failure to complete Schedule T in its entirety may result in no credit.

New Jersey also has a Schedule A to be completed by tiered partnerships.

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## New Mexico

### NMSA 1978 § 7-4-10(a) *Sourcing*

Except as provided in Subsections B and C of this section, all business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

### N.M. Code R. § 3.3.11.12 *Sourcing*

B. A taxpayer's distributive share of nonbusiness and business income shall be allocated and apportioned in accordance with this section (3.3.11.12 NMAC) to determine the portion of the distributive share of income taxable under the New Mexico Income Tax Act unless the taxpayer is qualified to elect, and has elected, to report the income in accordance with 3.3.11.8 NMAC . . .

D. The taxpayer shall apportion the taxpayer's distributive share of the unincorporated business entity's business income to New Mexico by multiplying the taxpayer's distributive share times the New Mexico apportionment percentage determined by application of the Uniform Division of Income for Tax Purposes Act to the entire business income of the unincorporated business entity. If the unincorporated business entity fails to provide the taxpayer with the necessary New Mexico apportionment percentage or information sufficient to enable the taxpayer to calculate the percentage, the taxpayer shall apportion the taxpayer's entire distributive share of business income as if all of the entity's activities, property, payroll and sales were in New Mexico.

### New Mexico Frequently Asked Questions about Direct Taxation of Pass-through Entities *PTE*

**If one of the partners or members of the PTE is a corporation, can the PTE elect to pay taxes directly? Can the PTE pay the taxes owed by a corporate partner or member of the PTE?**

The PTE cannot pay income tax directly with respect to any income allocable to a corporate partner that would include the income from the PTE in its New Mexico corporate income tax return as part of its unitary business income. The PTE will continue to withhold income taxes on behalf of such partners or members.

**What if one of the partners or members of the PTE is itself a PTE, such as a tiered partnership? Can each partner or member make the election?**

Yes, each partner in a tiered partnership makes its own, separate election. Each partner at each level of a tiered partnership may determine whether or not to make the election. So, for example, if Partnership A is a partner of Partnership B, both A and B can separately decide whether to make the election.

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## New York

### N.Y. Tax Law § 210(3) *Sourcing*

A corporation that is a partner in a partnership shall compute tax under this article using the aggregate method as defined in the regulations of the commissioner, unless another method for computing such tax is required or allowed by such regulations. Under the aggregate method, a corporation that is a partner in a partnership is viewed as

having an undivided interest in the partnership's assets, liabilities, and items of receipts, income, gain, loss and deduction. Under the aggregate method, the corporation that is a partner in a partnership is treated as participating in the partnership's transactions and activities.

N.Y. Comp. Codes R. & Regs. tit. 20, § 9-2.3 *Sourcing*

(a)(1) Under the aggregate method, the corporation's distributive share (see IRC section 704) of each partnership item of receipts, income, gain, loss, and deduction and the corporation's proportionate part of each partnership asset and liability and each partnership activity are included in the computation of the corporation's business income base, capital base, and the fixed dollar minimum tax and will have the same source and character in the hands of the corporate partner for article 9-A purposes as such item has in the hands of the partnership for Federal income tax purposes. Where an item, amount or activity of the partnership is not characterized for Federal income tax purposes or is not required to be taken into account for Federal income tax purposes, the source and character of each item, amount or activity of the partnership will be determined as if such item, amount or activity realized, incurred or experienced by the partnership were realized, incurred or experienced directly by the corporate partner . . .

(a)(4) Where a corporation is a partner in an upper tier partnership that is a partner in a lower tier partnership, the source and character of such corporation's distributive share or proportionate part, as the case may be, of each partnership item of receipts, income, gain, loss, deduction, asset, liability, and activity of the upper tier partnership that is attributable to the lower tier partnership retains the source and character determined at the level of the lower tier partnership. Such source and character are not changed by reason of the fact that such item flows through the upper tier partnership to such partner . . .

(b) Business income base. The corporation's distributive share of each partnership item of income, gain, loss, and deduction must be taken into account in the computation of entire net income and the business income base. These amounts must be taken into account in determining the corporation's business income, investment income, and other exempt income.

(c) Capital base. The corporation's proportionate part of each asset and liability of the partnership must be taken into account in the computation of the capital base. These amounts must be taken into account when determining business capital and investment capital. The capital base does not include any amount with respect to the corporation's interest in the partnership itself . . .

(f)(1) A corporation must include its distributive share of the partnership's business receipts when computing its BAF. Its distributive share of the partnership's business receipts during the applicable partnership year should be combined with the corporation's own receipts for the taxable year. The corporation must apportion such combined amounts using the rules specified in section 210-A and of this Subchapter. To the extent an apportionment rule uses a fraction to determine the amount of New York receipts, a corporation must include the distributive share or proportionate parts of any partnership amounts with the corporation's own amounts in such fraction. In addition, netting of gains and losses must be computed on the combined corporation and partnership amounts.

(f)(2) Where a corporation has receipts from sales to a partnership in which it is a partner, the corporation must reduce its receipts from its sales to the partnership by its distributive share of such purchases by the partnership. Where a partnership has receipts from sales to a corporation that is a partner in the partnership, the corporation

does not include its distributive share of the partnership receipts from sales to the corporation in its BAF.

(f)(4) In instances where an apportionment rule requires the use of a fraction to compute New York receipts, the corporation must use the sum of its own amounts for the taxable year and its distributive share or proportionate part, as the case may be, of partnership amounts during the applicable partnership year when computing such fractions

N.Y. Comp. Codes R. & Regs. tit. 20, § 9-2.2(c) *Sourcing*

If a corporation is a partner in a partnership ("upper tier partnership") and such partnership is a partner in another partnership ("lower tier partnership") and the corporation has the necessary information to use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and 374 liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership, but does not have the necessary information to use the aggregate method with respect to such items that are attributable to the lower tier partnership, then such corporation must use the aggregate method with respect to the items of receipts, income, gain, loss, deduction, assets and liabilities, and activities of the upper tier partnership that are not attributable to the lower tier partnership and must use the entity method with respect to such items that are attributable to the lower tier partnership. If there are additional tiers of partnerships, this methodology must be employed at each tier. The corporation will be presumed to have access to the necessary information with respect to a lower tier partnership and will be subject to the provisions of paragraph (2) of subdivision (b) of this section with respect to a lower tier partnership if one or more of the presumptions set forth in subdivision (a) of this section are met at each tier. If the corporation does not meet any of the presumptions set forth in subdivision (a) of this section and does not have access to the necessary information with respect to a lower tier partnership the provisions of paragraph (1) of subdivision (b) of this section will apply.

N.Y. Comp. Codes R. & Regs. tit. 20, § 9-2.4(e) Computation of tax under the entity method. *Sourcing*

A corporation must apportion its distributive share of partnership items of income, gain, loss and deduction included in its business income and its interest in the partnership included in its business capital by its BAF determined under Part 4 of this Subchapter, computed without regard to its distributive share of any partnership items of income, gain, loss or deduction.

Recent New York Regulations providing more detail on aggregate and entity methods *Sourcing*  
<https://www.tax.ny.gov/pdf/rulemaking/dec1123/corpreform/text.pdf>

New York Instructions for Form IT-204 (2023) *Sourcing*

Tiered partnerships (Regulation section 137.6) If your partnership is a partner in another partnership (hereinafter referred to as the lower tier partnership), the source and character of the distributive share of each item of your partnership to any partner of your partnership that is attributable to the lower tier partnership retains the source and character determined at the level of the lower tier partnership. Such source and character are not changed by reason of the fact that any such item flows through your partnership to such partner.

Example: Partnership A was a partner in another partnership, B. A is referred to as the upper tier partnership while B is referred to as the lower tier partnership. P was a non-resident individual partner of A. Partnership A was not engaged in a trade or business in New York but partnership B was. Even though partnership A was not carrying on business in New York, it had New York source income from the distributive shares it



received from partnership B. The source and character of each item that partnership A received from partnership B retains the source and character determined at the level of partnership B. For instance, if P was a partner of A, and A was a partner of B, nonresident individual partner P would allocate its share of the NY income from B at B's business allocation percentage. Further, if A was engaged in a trade or business in NY, then P would allocate its share of A's income using A's business allocation percentage and P would allocate its share of B's income (which flows to A) at B's business allocation percentage. This allocation method should be reflected on Forms IT-204 and IT-204-IP.

New York Frequently Asked Questions about the Pass-through Entity Tax *PTE*

**If an electing upper-tier partnership receives income from a lower-tier partnership that elected in to PTET, can the upper-tier partnership include the lower-tier partnership's income in PTE taxable income?**

The upper-tier partnership would include in PTE taxable income any amounts flowing to partners that are subject to tax under Article 22, including any income received from a lower-tier partnership.

New York TSB-M-21(1)C (August 25, 2021) *PTE*

A partnership must not include in its PTE taxable income any amounts of income, gain, loss, or deduction that flow through to a direct partner that is a partnership or an entity not subject to tax under Article 22, even if the income is ultimately taxable to a partner under Article 22 through tiered partnerships.

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## North Carolina

N.C. Gen. Stat. § 105-153.4(d) *Sourcing*

In order to calculate the numerator of the fraction provided in subsection (b) of this section for a partner in a partnership or a member of another unincorporated business that has one or more nonresident partners or members and operates in one or more other states, the amount of the partner's or member's distributive share of the total net income of the business, as modified in **G.S. 105-153.5** and **G.S. 105-153.6**, plus any guaranteed payments made to a partner from the partnership that is includable in the numerator is determined in accordance with the provisions of **G.S. 105-130.4**. As used in this subsection, total net income means the entire gross income of the business less all expenses, taxes, interest, and other deductions allowable under the Code that were incurred in the operation of the business.

17 N.C. Admin. Code 5C.1701 *Sourcing*

A corporation which is a member of a partnership or joint venture doing business in North Carolina is subject to North Carolina income tax and is required to include in the total net income subject to apportionment and allocation its share of the partnership's net income or net loss to the same extent required for federal income tax purposes.

17 N.C. Admin. Code 05C .1702 *Sourcing*

Income shall be classified as nonapportionable income where the corporate partner limits its connection to the partnership to the investment of funds or property and does not regularly or materially participate in the day-to-day operation of the partnership. Where the business of the partnership is directly or integrally related to the business of the corporate partner, the corporate partner's share of the partnership net income is classified as apportionable income. When classified as apportionable income, the corporate partner's apportionment factors shall include its proportionate share of the

partnership's property, payroll, and sales. If the income is classified as nonapportionable income, it shall be included in the corporate partner's net taxable income and allocated in accordance with the allocation provisions of G.S. 105-130.4.

North Carolina Administrative Decision No. 97-548 (April 24, 1998) *Sourcing*

Similar to most states, our law and rules do not distinguish between general and limited partners of a partnership. Furthermore, the rules are applicable for all tiers of the partnership structure. Hence, a corporate partner, which otherwise has no activities in this State, is subject to a corporate income and franchise tax on its distributive share of the partnership income if the partnership is "doing business" in North Carolina. The facts of this case clearly establish that the taxpayer is "doing business" in this State under the Department's rules. Here, [Limited Partnership One] is "doing business" in North Carolina by virtue of its ownership interest in [Limited Partnership Two] which operates in this State. The taxpayer, in turn, is "doing business" in North Carolina by virtue of its ownership interest in the [Limited Partnership One] partnership and is therefore subject to the corporate franchise and income tax imposed under G.S. 105-122 and G.S. 105-130.3, respectively.

Regarding the second issue, I find that the pass-through income derived from [Limited Partnership One] is properly classified as apportionable business income to the taxpayer. N.C. ADMIN. CODE tit. 17, r. 5C.1702 states, in pertinent part, that: "... Where the business of the partnership is directly or integrally related to the business of the corporate partner, the corporate partner's share of the partnership net income is classified as business income. When classified as business income, the corporate partner's apportionment factors shall include its proportionate share of the partnership's property, payrolls and sales."

The taxpayer asserts that, in the event a filing requirement is established, the business of [Limited Partnership One] is not directly or integrally related to its business because the taxpayer does not have a unitary relationship with the general partner of the partnership, [Limited Partnership Two], and therefore, the income is properly classified as nonbusiness income. The evidence of record clearly shows that the taxpayer is a passive holding company with a [percentage] limited partnership interest in [Limited Partnership One] and a [percentage] ownership in [Corporation One], the general partner of [Limited Partnership One] and [Limited Partnership Two]. The evidence also shows that [Limited Partnership One] owns a [percentage] limited partnership interest in the operating partnership, [Limited Partnership Two], which owns and operates restaurants in North Carolina. Therefore, the taxpayer and [Limited Partnership One] are directly and integrally related by common ownership. The issues of whether the corporate partner manages the operations of the partnership, or whether the general partner and the limited partner have a unitary relationship are irrelevant to the question of whether the businesses of the taxpayer and [Limited Partnership One] are directly or integrally related. I find that the businesses of the taxpayer and [Limited Partnership One] are directly or integrally related and therefore the income from [Limited Partnership One] constitutes business income to the taxpayer.

The taxpayer further asserts that its pro-rata share of [Limited Partnership One]'s net income should be classified as nonbusiness income allocable to [state other than North Carolina], the state of its commercial domicile, because it limits its connection to [Limited Partnership One] to the mere investment of funds and does not materially participate in the day-to-day operations of the partnerships. However, I am unpersuaded by this argument, which implies that a passive holding company is not a business and does not produce any business income anywhere. A company of this type engages in no other business activity apart from its ownership interest in its investments. Therefore, its principal business activity is its investments, and income derived from those investments is business income.

In any event, under no circumstance would the income from [Limited Partnership One] be allocated to the commercial domicile of the taxpayer as it contends. N.C. ADMIN. CODE tit. 17, r. 5C.1702 provides that the corporate partner's net taxable income be apportioned and/or allocated to this State in accordance with the apportionment and allocation provisions of G.S. 105-130.4. Section (h) of the statute states that: "The income less related expenses from any other nonbusiness activities or investments not otherwise specified in this section is allocable to this State if the business situs of the activities or investments are located in this State." Therefore, even if such income were classified as nonbusiness income to the taxpayer, it would be at least partly allocable to this State and subject to taxation in this State because the situs of some of the restaurants giving rise to the pass-through income is in North Carolina. Under the applicable statute and rules, however, the income from [Limited Partnership One] to is clearly apportionable business income.

Finally, the Department submitted an Attorney General's Opinion dated January 7, 1947 as evidence and support of its long-standing position concerning its treatment of the corporate partner and the identification of the pass-through income of a partnership "doing business" in this State. In addition, the Department has formulated and issued rules to instruct the corporate partner of a partnership "doing business" in this State of its filing requirements and the proper treatment of the pass-through income from the partnership. These rules clearly establish that the taxpayer is required to file corporate franchise and income tax returns and apportion its business income to this State. Therefore, I find that the denial of the refunds requested on the amended corporate franchise and income tax returns and the proposed assessment for unpaid franchise tax were proper under the facts and law.

#### North Carolina Corporate Income Tax Directive PD-14-02 (October 10, 2014) *Sourcing*

The Department has recently reviewed its position on apportionment and allocation of partnership income. The Department has determined that the requirement in G.S. 105-153.4(d) to use the ratio calculated under the corporate apportionment formula in G.S. 105-130.4 necessarily includes use of an alternative apportionment method approved by the Secretary as well as use of the statutory apportionment formulas set out in G.S. 105-130.4(i) and G.S. 105-130.4(m) through (s1). The Department has also concluded that it imprudently exercised its authority under G.S. 105-262 and G.S. 105-264 when it required or allowed partnerships to separately account for business activities that were segregated from other business activities. Finally, the Department has determined that in many cases a partnership misconstrued the Department's guidance by segregating a portion of its apportionable income because it employed a method of accounting that clearly reflected the income of a specific activity.

As a result of the review, the Department will revise its partnership income tax return form and instructions for 2014 to remove provisions for reporting income from segregated activities. The Department believes that, under a constitutionally sound apportionment method, income from unitary business activities is apportionable and income from an activity that is not part of the unitary business activities is allocated to the business situs of the activity. Consequently, the partnership tax return form will also be revised to include a line for reporting nonapportionable income from North Carolina sources and a line for reporting apportionable income subject to North Carolina's apportionment factor.

If a partnership believes that the statutory apportionment formula attributes a greater portion of its income to North Carolina tax than is reasonably attributable to its business in this State, it may make a written request with the Secretary of Revenue for permission to use an apportionment formula that it believes is a better method to attribute its income to North Carolina. The procedures set forth in administrative rule T17 NCAC

Chapter 5D .0107 through .0115 for a corporation to request an alternative apportionment formula will also apply to a partnership seeking an alternative apportionment formula.

#### North Carolina Form D-403A Instructions (2022) *Sourcing*

A partnership with one or more nonresident partners whose business activities in N.C. are unified and integrated with its business activities in other states is required to apportion its partnership income to N.C. by multiplying the income by a fraction, the numerator of which is the total sales of the partnership within N.C., and the denominator of which is the total sales of the partnership everywhere during the income year.

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### North Dakota

#### N.D. Cent. Code § 57-38-08.1 *Sourcing*

- (1) A partnership that carries on its business activity entirely within this state shall report all of its income or loss to this state. A partnership that carries on its business activity within and without this state shall allocate and apportion its income or loss to this state in the same manner as the income or loss of a corporation is allocated and apportioned to the state under chapter 57-38.1.
- (2) Resident partners, limited to individuals, estates, and trusts, must report their entire distributive share to this state as provided in subdivision b of subsection 6 of section 57-38-04, and may claim a credit for taxes paid to another state on that portion of their distributive share attributable to and taxed by another state, as provided in subdivision j of subsection 1 of section 57-38-30.
- (3) (a) In determining the gross income of a nonresident partner, limited to individuals, estates, and trusts, there must be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss and deduction, or item thereof, entering into the federal taxable income of the partner, as determined under section 57-38-04 . . .  
(c) Any modification to federal taxable income described in this chapter that relates to an item of partnership income, gain, loss, or deduction, or item thereof, must be made in accordance with the partner's distributive share, for federal income tax purposes, of the item to which the modification relates, but limited to the partner's portion of the item derived from or connected with sources in this state.  
(d) On application, the commissioner may authorize the use of other methods of determining a nonresident partner's portion of partnership items derived from or connected with sources in this state, and the related modifications, as may be appropriate and equitable, on the terms and conditions as it may require.

#### N.D. Cent. Code § 57-38-04 *Sourcing*

- (4) Income derived from business activity carried on by an individual as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, must be assigned to this state without regard to the residence of the individual if the business activity is conducted wholly within this state. Income derived from gaming activity carried on in this state by an individual must be assigned to this state without regard to the residence of the individual.
- (5) Whenever business activity is carried on partly within and partly without this state by a nonresident of this state as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, the entire income therefrom must be allocated to this state and to other states, according to the provisions of chapter [57-38.1](#) but only according to the apportionment method provided under subsection 1 of section [57-38.1-09](#), providing for allocation and apportionment of income of corporations doing business within and without this state.

(6)

(a) Income and gains received by a resident of this state from tangible property not employed in the business and from tangible property employed in the business of the taxpayer, if the business consists principally of the holding of the property and the collection of income and gains from the business, must be assigned to this state without regard to the situs of the property.

(b) Income derived from business activity carried on by residents of this state, whether the business activity is conducted as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, must be assigned to this state without regard to where the business activity is conducted, and the provisions of chapter [57-38.1](#) do not apply. If the taxpayer believes the operation of this subdivision with respect to the taxpayer's income is unjust, the taxpayer may petition the tax commissioner who may allow use of another method of reporting income, including separate accounting.

#### N.D. Admin. Code 81-03-05.3-03(2)(d) (worldwide) *Sourcing*

When apportionable income includes income from a corporation's ownership interest in a general partnership, the corporate partner's share of the partnership's property, payroll, and sales must be included in the group's apportionment factors.

#### North Dakota Tax Website *Sourcing*

Apportionment - All income derived from the partnership's activity is business income and is subject to apportionment. For the definitions of business and nonbusiness income, see North Dakota Administrative Code § 81-03-09. North Dakota does not allow for separate accounting.

#### N.D. Cent. Code § 57-38-31.1 *Withholding/Return*

(3)(a) A passthrough entity shall withhold income tax, at the highest tax rate provided in section 57-38-30.3, on the share of income of the entity distributed to each nonresident member and pay the withheld amount in the manner prescribed by the tax commissioner. The passthrough entity is liable to the state for the payment of the tax required to be withheld under this section and is not liable to any member for the amount withheld and paid in compliance with this section. A member of a passthrough entity that is itself a passthrough entity (a lower-tier passthrough entity) is subject to this same requirement to withhold and pay income tax on the share of income distributed by the lower-tier passthrough entity to each of its nonresident members. The tax commissioner shall apply tax withheld and paid by a passthrough entity on distributions to a lower-tier passthrough entity to the withholding required of that lower-tier passthrough entity.

(3)(c) Notwithstanding subdivision a, a passthrough entity is not required to withhold tax for a nonresident member if . . .

(5) The member is a lower-tier passthrough entity that elects to be exempted from the withholding requirement under this subsection. The election must be made on a form and in a manner prescribed by the tax commissioner. The form must include a statement that the member certifies that the member will file any return and pay any tax required by this chapter on its distributive share of income from the source passthrough entity and that the member is subject to this state's jurisdiction for the collection of that tax and any applicable penalty and interest. The tax commissioner may revoke the exemption under this paragraph if the source passthrough entity or member fails to comply with the requirements of this paragraph. If the exemption is revoked, the source passthrough entity shall begin withholding from the member within sixty days

of receiving notification of the revocation from the tax commissioner. The tax commissioner may prescribe any procedures and guidelines necessary to administer this paragraph.

#### North Dakota Tax Website *Withholding/Return*

A partnership does not have to withhold North Dakota income tax from a nonresident partner's distributive share of North Dakota income if:

- The distributive share for the taxable year is less than \$1,000; or
- In lieu of filing the North Dakota income tax return by the nonresident partner, the nonresident partner elects to be included in a composite filing by the passthrough entity.
- The nonresident partner is a passthrough entity and elects to exempt its distributive share of North Dakota income from withholding. This election is made on Form PWE – Passthrough Withholding Entity Member Withholding Exemption & Certification and remains in effect until it is revoked by the nonresident passthrough entity.
- The nonresident partner is an individual who meets the qualifying conditions and completes the Form PWA. For the qualifying conditions, see Form PWA – Passthrough Withholding Adjustment – Nonresident Member.

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## Ohio

### Ohio Rev. Code Ann. § 5747.21 *Sourcing*

(B) Except as otherwise provided under section 5747.212 of the Revised Code, all items of business income and business deduction shall be apportioned to this state by multiplying business income by the fraction calculated under division (B)(2) of section 5733.05 and section 5733.057 of the Revised Code as if the taxpayer's business were a corporation subject to the tax imposed by section 5733.06 of the Revised Code.

(C) If the allocation and apportionment provisions of sections 5747.20 to 5747.23 of the Revised Code or of any rule adopted by the tax commissioner, do not fairly represent the extent of business activity in this state of a taxpayer or pass-through entity, the taxpayer or pass-through entity may request, which request must be in writing accompanying a timely filed return or timely filed amended return, or the tax commissioner may require, in respect of all or any part of the business activity, if reasonable, any one or more of the following

- (1) Separate accounting;
- (2) The exclusion of one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the business activity in this state;
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of such business in this state. An alternative method will be effective only with approval of the tax commissioner.

The tax commissioner may adopt rules in the manner provided by [sections 5703.14](#) and [5747.18](#) of the Revised Code providing for alternative methods of calculating business income and nonbusiness income applicable to all taxpayers and pass-through entities, to classes of taxpayers and pass-through entities, or only to taxpayers and pass-through entities within a certain industry

For As used in this section, “adjusted qualifying amount” has the same meaning as in section 5733.40 of the Revised Code.

This section does not apply to division (AA)(5)(a)(ii) of section 5747.01 of the Revised Code.

Except as set forth in this section and except as otherwise provided in divisions (A) and (B) of section 5733.401 of the Revised Code, in making all apportionment, allocation, income, gain, loss, deduction, tax, and credit computations under this chapter, each person shall include in that person's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales, the person's entire distributive share or proportionate share of the items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, \*apportionable income or loss, property, compensation, and sales of any pass-through entity in which the person has a direct or indirect ownership interest at any time during the person's taxable year. A pass-through entity's direct or indirect distributive share or proportionate share of any other pass-through entity's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales shall be included for the purposes of computing the person's distributive share or proportionate share of the pass-through entity's items of business income, nonbusiness income, adjusted qualifying amounts, allocable income or loss, apportionable income or loss, property, compensation, and sales under this section. Those items shall be in the same form as was recognized by the pass-through entity.

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## Oklahoma

### Okla. Stat. tit. 68, § 2358(A) *Sourcing*

(4)(c) income or loss from a business activity which is not a part of business carried on within or without the state of a unitary character shall be separately allocated to the state in which such activity is conducted . . .

(5) The net income or loss remaining after the separate allocation in paragraph 4 of this subsection, being that which is derived from a unitary business enterprise, shall be apportioned to this state on the basis of the arithmetical average of three factors consisting of property, payroll and sales or gross revenue enumerated as subparagraphs a, b and c of this paragraph.

### Okla. Admin. Code § 710:50-19-1(a) *Sourcing*

(1) Oklahoma source income or loss. When a partnership has source income or loss then that partnership must file a return showing the income or loss applicable to Oklahoma. The partnership shall also furnish a detailed schedule stating the amount of income distributable to each partner from Oklahoma sources.

(2) Duty to file and report; determination of shares. All resident partners must file individual income tax returns with Oklahoma if they are required to file individual Federal Income Tax Returns. All nonresident partners that have gross income of \$1,000.00 must file an Oklahoma Return even though their net may actually be a loss. The partnership income for Oklahoma may be apportioned using the three factor formula unless its operations are from real and tangible personal property, such as rents, oil and mining production or royalties, and gains or losses from sales of such property; then the income or loss shall be allocated in accordance with the situs of such property. The

partner's distributive share of Oklahoma income or loss shall be the same proportion to the partner's distributive share of income or loss shown on the Federal Partnership Return.

Okla. Admin. Code § 710:50-19-1(a)(15) *Sourcing*

(A) Partnership income or loss shall be separately allocated. [See: 68 O.S. § 2358(A)(4)]

(B) The Oklahoma distributive share of partnership income as determined under 68 O.S. § 2358 and 68 O.S. § 2362 shall be allocated to Oklahoma.

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## Oregon

Or. Rev. Stat. § 316.124 *Sourcing*

- (1) In determining the adjusted gross income of a nonresident partner of any partnership, there shall be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss and deduction (or item thereof) entering into the federal adjusted gross income of the partner, as such part is determined under rules adopted by the department in accordance with the general rules in ORS 316.127 . . .
- (4) The department may, on application, authorize the use of such other methods of determining a nonresident partner's portion of partnership items derived from or connected with sources in this state, and the modifications related thereto, as may be appropriate and equitable, on such terms and conditions as it may require.

Or. Rev. Stat. § 314.714(1) *Sourcing*

Each item of partnership income, gain, loss or deduction has the same character for a partner as it has for federal income tax purposes. If an item is not characterized for federal income tax purposes, it has the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Or. Admin. R. 150-314-0385 *Sourcing*

- 8) The apportionment factors of a corporation that is a member of a partnership, limited liability company treated as a partnership, or unincorporated joint venture (i.e. the "related entity"), that is a part of the corporation's overall business operations, must include the corporation's share of the property, payroll, and sales of the related entity. For the purpose of computing the apportionment factors, transactions between the corporation and the related entity must be eliminated to the extent of the corporation's percentage of interest in the related entity. The corporation's share of the related entity's property, payroll, and sales are based on its percentage of interest in the related entity that is equal to the ratio of its capital account plus its share of the related entity's debt to the total of the capital accounts of all members of the related entity plus total related entity debt. The capital accounts of the members must reflect the average of the accounts for the period of the tax return. The average of the capital accounts may be computed by averaging the beginning and ending balances or monthly balances. Capital accounts of a related entity must be adjusted to reflect a member's adjusted basis in contributed property, rather than fair market value. The corporation's share of a related entity's debt is determined under IRC 752(a) and 752(b) and the regulations thereunder, irrespective of whether or not the related entity is a true partnership.
- 9) For the purpose of computing the apportionment factors for a consolidated Oregon return, inter-company transactions between a unitary affiliate of a partner or member and the related entity described in section (8) of this rule are treated the



same as intercompany transactions directly between the affiliated corporations, to the extent of the corporate partner's or member's ownership share of the related entity. Inter-company transactions between affiliated corporations filing a consolidated Oregon return are eliminated as provided in section (3) of OAR 150-317-0620.

**Example:** Corporations A, B, and C file a consolidated Oregon return. A and B each own 50 percent of partnership P. P is part of the overall business operations of the three corporations. P buys 80 percent of its raw materials from C. The intercompany sales between P and C must be eliminated from the apportionment formula for the consolidated Oregon return of the corporations. Transactions between C and P are considered to be directly between the three corporations.

Or. Admin. R. 150-314-0510(7) *Sourcing*

"Oregon-source distributive income" means the portion of the PTE's modified distributive income that is derived from or connected with Oregon sources. For PTEs operating in Oregon and one or more other states, Oregon-source distributive income is determined by attributing to Oregon sources that portion of the modified distributive income of the PTE, as defined in section (6) of this rule, determined in accordance with the allocation and apportionment provisions of ORS 314.280 or ORS 314.610 to 314.675.

Oregon Revenue Bulletin 2010-02 (March 29, 2010) *Sourcing*

Tiered entities: A partnership that isn't otherwise doing business in Oregon may owe the partnership minimum tax if it owns an interest in another partnership—including an LLC classified as a partnership—that is doing business in Oregon. If the partnership is involved in the Oregon business or acts on behalf of the Oregon business, the partnership is doing business in Oregon and subject to the partnership minimum tax. Generally, limited partners aren't involved in a partnership's activities and don't act on behalf of the partnership. Each partnership must look at the facts and circumstances to determine if it's doing business in Oregon for a particular tax year.

Example 4: Albany Associates is a limited partnership doing business in Oregon. Phoenix LLC is classified as a partnership and owns 20 percent of Albany Associates as a limited partner. Phoenix LLC has no other activity, property, or ties to Oregon and doesn't own an interest in any other entity doing business in Oregon. Phoenix LLC isn't involved in the operation of Albany Associates and doesn't perform any actions on behalf of Albany Associates. Phoenix LLC is not doing business in Oregon. Although Phoenix LLC still has Oregon-source income taxable to its owners and must file an Oregon partnership return, it doesn't owe the partnership minimum tax.

Example 5: Detroit LLC owns a 40-percent stake in Ontario Enterprises, an Oregon partnership doing business in Oregon. Detroit LLC files as a partnership and is involved in the operation of Ontario Enterprises. Detroit LLC owes the partnership minimum tax. Bend Associates owns 20 percent of Detroit LLC and manages Detroit LLC's affairs, including its actions as a general partner of Ontario Enterprises. Bend Associates is involved in the activities of Ontario Enterprises; therefore, Bend Associates also owes the partnership minimum tax.

Example 6: Pittsburgh LLC owns 40 percent of Waldport LLC, an Oregon LLC classified as a partnership and doing business in Oregon. Pittsburgh LLC has no involvement in Waldport LLC, which is operated by the other owners. Pittsburgh LLC is not otherwise doing business in Oregon. Pittsburgh LLC doesn't owe the partnership minimum tax. However, Pittsburgh LLC must file a partnership return for Oregon because it has Oregon-source income that flows through to its owners.

"The obligation for the PTE to withhold is triggered when the PTE has "distributive income from Oregon sources." That, of course, requires the entity to determine, at the entity level, whether it has income from Oregon sources. The entity cannot rely on some later recalculation by an owner or an auditor, done at the owner level, to determine if the owner has distributive income from Oregon sources in respect of which it has a withholding obligation . . . Nothing in the rule addresses the critical step in the department's method that combines incomes and apportionment factors. In the case of corporate partners, the combination of income and factors from partnerships with other income and factors [\*28] occurs, if at all, based on the combination requirements effectively included in [ORS 317.705 to 317.715 .49](#) However, as discussed, such combination requires statutory authority beyond UDITPA and no such statutory authority exists in respect of nonresident individuals . . . The court has considered the text of the partnership tax statutes, the context of those statutes, especially the provisions of the PTE statutes and rules, the history of combined reporting in Oregon and the text and context of UDITPA. None of these is consistent with the department position in this case—a position requiring what is essentially combined reporting and apportionment at the owner level.

#### Oregon Form OR-21 Instructions (2022) *PTE*

An upper-tier PTE that is a member of an electing PTE will also use Form OR-21 to pass its share of the lower-tier entity's distributive proceeds, addition, and tax credit through to the upper-tier PTE's individual owners . . . An electing PTE must be a partnership, an S corporation, or an LLC taxed as a partnership or S corporation. All of the PTE's members must be individuals or other PTEs (uppertier PTEs) whose members are all individuals . . . A PTE that is an upper-tier member of the electing PTE must pass its share of the lower-tier entity's distributive proceeds, addition and refundable tax credit through to its own members. All of the upper-tier PTE's members must be individuals who will file a personal income tax return, including nonresident individuals who elect to join a composite return. The upper-tier PTE must report the information about the items passed through to its members by filing Form OR-21 with Schedule OR-21-MD-PT attached. See Schedule OR-21-MD-PT Instructions for more information. In addition, the upper-tier PTE must provide Schedule OR-21-K-1 to each of its individual members to report the distributive proceeds, addition, and credit passing through from the lower-tier electing entity, even if the upper-tier PTE isn't making the election . . . Individual PTE members must report an addition for any taxes imposed on the PTE by Chapter 314 of the Oregon Revised Statutes and paid to the State of Oregon that are deducted on any federal return filed by the PTE at the entity level. If the electing PTE has an upper-tier PTE as a member, the upper-tier PTE's members must report the addition on their personal income tax returns, including composite returns joined by nonresident individuals. The PTE must include the addition amount on the Schedule OR-21-K-1 provided to each member . . . Individual PTE members are allowed a refundable credit for their distributive share of the tax paid by the PTE. The credit is claimed on the member's personal income tax return. If the electing PTE has an upper-tier PTE as a member, the upper-tier PTE's members are allowed to claim the credit on their personal income tax returns, including composite returns joined by nonresident individuals. The distributive share of the credit must be reported to each member using Schedule OR-21-K-1, including members that are other PTEs. Don't include interest or penalty on unpaid tax or underpayment interest in the tax credit amount. See Schedule OR-21-K-1 Instructions . . .

#### Oregon PTE-E Frequently Asked Questions *PTE*

##### **What if the PTE also does business outside Oregon?**

If the PTE does business both inside and outside Oregon, it must apportion its income according to Oregon's Uniform Division of Income for Tax Purposes Act, ORS 314.605 to 314.675, unless the PTE is a financial institution or public utility. In that case, the PTE must apportion its income using the provisions of ORS 314.280. See Schedule OR-AP Instructions, Apportionment of Income for Corporations and Partnerships, for information about apportioned and allocated income.

### **How does the PTE figure its income from Oregon sources?**

From its total income from the sources listed above, the PTE must subtract the amount that isn't apportionable. Then it multiplies the remaining amount by its apportionment percentage. Use Schedule OR-AP Instructions as a guide for estimating the apportionment percentage. Then, from the income that isn't apportionable, add back income that must be allocated to Oregon. This is the PTE's total amount of distributive proceeds from Oregon sources.

Or. Rev. Stat. § 314.781(6) *Withholding/Return*

The department shall apply taxes withheld under this section by a lower-tier pass-through entity on distributions to an upper-tier pass-through entity to the withholding required by the upper-tier pass-through entity under this section.

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## Pennsylvania

72 P.S. § 7402.2(a) *Sourcing*

Except as set forth in subsection (b), for purposes of this article, a corporation's interest in an entity which is not a corporation shall be considered a direct ownership interest in the assets of the entity rather than an intangible interest.

61 Pa. Code § 153.29 *Sourcing*

(a)(1) When a taxpayer has an interest in a partnership, joint venture, association or other unincorporated enterprise (hereinafter referred to in this section as partnership), the amount of its distributive share of partnership income shall be determined in accordance with the IRC. The taxpayer's interest in the partnership shall, for purposes of Commonwealth corporate taxation, be considered a direct interest in the assets of the partnership rather than an intangible interest. Accordingly, the taxpayer's share of the partnership's payroll, property and sales—as hereafter determined—shall be included in the apportionment factors of the taxpayer unless otherwise excluded by this section.

(a)(2) A taxpayer's partnership interest for the purpose of computing the portion of the partnership's property, payroll and sales to be included in the taxpayer's property, payroll and sales factors shall be determined under the partnership agreement and in accordance with the IRC.

(b)(1) If the separate activities of the taxpayer or the activities of the partnership are sufficient to meet the conditions of section 401(1) of the TRC (72 P.S. § 7404(1)) relating to doing business, carrying on activities, having capital or property employed or used or owning property within this Commonwealth, then the taxpayer will be subject to corporate taxation by the Commonwealth.

(b)(2) If the separate activities of the taxpayer or the activities of the partnership are sufficient to constitute transacting business outside this Commonwealth and render the taxpayer taxable to another state under section 401(3)2.(a)(2) and (3) of the TRC

(72 P.S. § 7401(3)2.(a)(2) and (3)), then the taxpayer will be allowed to apportion and allocate its income.

(c)(1) Income arising from transactions and activity in the regular course of the taxpayer's trade or business constitutes business income. The determination of whether a corporate partner's distributive share of partnership income is business income depends upon whether the income arose in the regular course of the taxpayer's trade or business, determined in accordance with § 153.24 (reserved). The taxpayer's trade or business shall include activities performed in partnership.

(c)(2) The classification of income by the labels customarily given such as interest, rents, royalties, and capital gains, is of no aid in determining whether distributive partnership income is business or nonbusiness income. The income is determined to be either business or nonbusiness income depending upon the relationship to the trade or business of the corporate partner, not of the partnership, as determined by paragraph (1).

(d) A corporate partner entitled to apportionment under subsection (b)(2) shall determine the business income attributable to this Commonwealth by use of a three-factor formula consisting of property, payroll, and sales of the taxpayer including its share of the partnership's property, payroll, and sales for a partnership year ending within or with the taxpayer's tax year as follows. . .

#### 61 Pa. Code § 109.5(a) *Sourcing*

If a nonresident individual, or a partnership of which a nonresident individual is a member, carries on a business, trade, profession, or occupation both within and without this Commonwealth, the items of income, gain, loss and deduction attributable to such business, trade, profession, or occupation shall be apportioned and allocated to this Commonwealth on a fair and equitable basis in accordance with approved methods of accounting.

*IN RE: Global Equity Shareholder*, Pennsylvania Board of Finance and Revenue Decision No. 1617207 (April 9, 2021) *Sourcing*

"Petitioner filed the instant petition for review of reassessment at the Board of Finance and Revenue on November 28, 2016, again, claiming the above-listed issue. Petitioner contends that its apportionment factor should be [REDACTED]% because it does not conduct any activities or employ anyone in Pennsylvania. Petitioner explains that its ownership in publicly traded pass-through partnerships that do business in Pennsylvania is minimal but it is unable to obtain Pennsylvania-related property and payroll factors.

#### **Conclusion**

Petitioner's request for relief is denied because Petitioner failed to meet its burden of proof pursuant to 72 P.S. § 9705.

If a corporation carries on a business both within and without Pennsylvania, the items of income, gain, loss and deduction attributable to such business can be apportioned and allocated to Pennsylvania on a fair and equitable basis in accordance with approved methods of accounting. *See* 72 P.S. § 7401 (3)(2).(a)(2)-(3); 61 Pa. Code § 109.5. Corporations having income from business activity within and without the state are entitled to use three-factor apportionment. *Id.*

When a taxpayer has an interest in a partnership, joint venture, association or other unincorporated enterprise the interest in the partnership shall be considered a direct interest in the assets of the partnership rather than an intangible interest. *See* 72 P.S. § 7602.6; 61 Pa. Code § 153.29. Accordingly, the taxpayer's share of the partnership's

payroll, property, and sales shall be included in the apportionment factors of the taxpayers. *Id.*

Every petition for refund or review filed with the Board shall set forth the facts and points of law which the petitioner relies and Petitioner has the burden of proof to supply sufficient evidence to support its claim. 72 P.S. § 9705. Petitioner has not submitted the proportionate share of the property, payroll, and sales factors of all of its investee partnerships in which it has an ownership interest. Therefore, there is not sufficient evidence to grant this claim.”

*IN RE: Starfire Holding Corporation*, Pennsylvania Board of Finance and Revenue Decision No. 2004864 (April 3, 2017) *Sourcing*

“Petitioner's lower-tier entity income share is not entitled to nonbusiness income treatment. Under the transactional test, the pass-through income is business income because this income was derived from transactions in which Petitioner regularly engaged, investment in securities and in pass-through entities. *Welded Tube Company of America v. Com.*, 101 Pa. Commw. 32, 515 A.2d 988 (1986); 61 Pa. Code § 153.29(c)(1) (taxpayer's regular trade or business include those performed in a partnership). When deriving income from lower-tier entities is viewed in light of Petitioner's past business history, the lower-tier income was derived from the conduct of Petitioner's regular business. *Ross-Araco Corp. v. Com.*, 165 Pa. Commw. 49, 644 A.2d 235 (1994), *aff'd*, 544 Pa. 74, 674 A.2d 691 (1996) (holding that gain from land sale was nonbusiness income when transaction was only land sale by taxpayer; gain was used to buy government bonds; and land was used only to obtain performance bid bonds, but did not directly produce business income). Petitioner regularly engaged in investment including the acquisition of partnerships and limited liability companies to accomplish Petitioner's business purposes.

Petitioner did not prove that the acquisition and management of the lower-tier entities producing the income at issue were not integral parts of Petitioner's investment trade or business. Under the clarified functional test, the lower-tier income was business income because the acquisition and management of other entities constituted an integral part of Petitioner's regular trade or business. See 72 P.S. § 7401(3)2.(a)(1)(A); *Glatfelter Pulpwood Company v. Com.*, 61 A.3d 993 (Pa. 2013) (affirming the Commonwealth Court decision). These lower-tier entities were acquired or formed because of Petitioner's investment business and when sold, the gains remained business income.

Petitioner has not shown that it is entitled to multiform/unrelated income treatment. When multistate businesses are conducted in a way that some of the business operations outside Pennsylvania are independent of and do not contribute to the business operations within Pennsylvania, the business may exclude the factors attributable to the outside activity. *Com. v. ACF Indus., Inc.*, 271 A.2d 273, at 280 (Pa. 1970). The burden of proof in a multiform/unrelated income case lies with the taxpayer who must clearly show the unrelated nature of the income it seeks to exclude. See *Container Corp. of America v. Franchise Tax Bd. of Cal.*, 463 U.S. 159, at 180-81 (1983). Petitioner has not demonstrated it is a multiform business and has not proved how its share of lower-tier entity income was unrelated to its Pennsylvania income when these entities were also Petitioner's investments and, thus, Petitioner's request for multiform/unrelated income treatment is denied. See *id.*”

*IN RE: New SR Capital Associates LLC*, Pennsylvania Board of Finance and Revenue Decision No. 1513962 (July 13, 2016) *Sourcing*

The Petitioner held an interest in more than 150 tiered partnerships or limited liability companies. Five of those entities had Pennsylvania-sourced income. Petitioner appealed the assessment to the Board of Appeals claiming that it did not conduct business

in Pennsylvania. Petitioner argued that, although it is had an ownership interest in five entities with Pennsylvania sourced income and expenses, it did not own or rent property or have any employees in the Commonwealth. Consequently, Petitioner argued, it properly reported its apportionment.

The Board ruled “[i]n the instant case, Petitioner indicates it has interests in five entities with Pennsylvania source income. Two of these entities are partnerships. However, Petitioner failed to include the source income amounts from these partnerships in its apportionment factors. While Petitioner has submitted a revised RCT-101, amending the denominators of its three apportionment factors from “[REDACTED]” to “[REDACTED],” this Board finds that Petitioner has failed to prove its proposed apportionment factor denominator of “[REDACTED].” Importantly, Petitioner has failed to provide federal returns of investee entities to support its proposal. Petitioner failed to provide source documents to reconcile the difference between the factors reported on its two RCT-101’s, or any supporting documentation with respect to its total property, payroll or sales figures. Consequently, this Board finds that Petitioner has failed to satisfy its burden of proof pursuant to 72 P.S. § 9705.”

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## Rhode Island

### R.I. Gen. Laws § 44-30-14(a) *Sourcing*

In the case of a taxpayer deriving its income from sources both within and outside of this state or engaging in any activities or transactions both within and outside of this state for the purpose of profit or gain, its net income shall be apportioned to this state by means of an allocation fraction to be computed as a simple arithmetical mean of three (3) fractions . . .

### R.I. Gen. Laws § 44-30-15(b) *Sourcing*

Each item of partnership income or deduction shall have the same character for a partner as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

### R.I. Gen. Laws § 44-30-34(a) *Sourcing*

In determining Rhode Island income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with Rhode Island sources of the partner’s distributive share of items of partnership income and deduction entering into his or her federal adjusted gross income, as such portion shall be determined under regulations of the tax administrator consistent with the applicable rules of § 44-30-32.

### R.I. Gen. Laws § 7-16-73(c)(4) *Sourcing*

A non-resident member is required to file a Rhode Island income tax return even though the member’s only source of Rhode Island income was that member’s share of the limited liability company’s income that was derived from or attributable to sources within this state, and the amount of remittance by the limited liability company on behalf of the non-resident member shall be allowed as a credit against that member’s Rhode Island income tax liability.

*Homart Development Co. v. Norberg*, 529 A2d 115 (R.I. 1987) *Sourcing*

“The inclusion of this income in Homart's net-income calculation for apportionment purposes necessarily requires that the payroll, property, and receipt factors that gave rise to it be included in the apportionment equation also. Otherwise, the net income is subject to an apportionment ratio that reflects only Homart's in-state and everywhere business activity when, in fact, this income did not arise from Homart's corporate business activity but instead arose out of the partnerships' business activities that were not reflected in the apportionment ratio. Such an inherent and manifest distortion as applied to this taxpayer should have been acknowledged and remedied by the tax administrator as provided for under § 44-11-15.”

280 R.I. Code R. § 20-25-9.7(B) *Sourcing*

Treatment of C Corporation's Pass-Through Entity Income. When a partnership or other pass-through entity does not elect to be taxed as a corporation for federal tax purposes and is directly or indirectly held by a corporation, including any member in a combined group, then the business conducted by the partnership or pass-through entity shall be considered the business of the corporation to the extent of the corporation's distributive share of the partnership or pass-through entity income. Such distributive share shall be included in the net income calculations of the corporation and the combined group, and shall be apportioned to Rhode Island for corporate income tax purposes as set forth in this Regulation, consistent with the decision reached by the Rhode Island Supreme Court in *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987).

R.I. Gen. Laws § 44-11-2.2(b)(1) *Withholding/Return*

A pass-through entity shall withhold income tax at the highest Rhode Island withholding tax rate provided for individuals or seven percent (7%) for corporations on the member's share of income of the entity that is derived from or attributable to sources within this state distributed to each nonresident member and pay the withheld amount in the manner prescribed by the tax administrator. The pass-through entity shall be liable for the payment of the tax required to be withheld under this section and shall not be liable to the member for the amount withheld and paid over in compliance with this section. A member of a pass-through entity that is itself a pass-through entity (a “lower-tier pass-through entity”) shall be subject to this same requirement to withhold and pay over income tax on the share of income distributed by the lower-tier pass-through entity to each of its nonresident members. The tax administrator shall apply tax withheld and paid over by a pass-through entity on distributions to a lower-tier pass-through entity to the withholding required of that lower-tier pass-through entity.

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## South Carolina

S.C. Code Ann. § 12-6-600 *Sourcing*

An entity treated as a partnership for federal income tax purposes is not subject to tax under this chapter. Each partner shall include its share of South Carolina partnership income on the partner's respective income tax return. All of the provisions of the Internal Revenue Code apply to determine the gross income, adjusted gross income, and taxable income of a partnership and its partners, subject to the modifications provided in Article 9 of this chapter and subject to allocation and apportionment as provided in Article 17 of this chapter.

S.C. Code Ann. Regs. 117-705.1 *Sourcing*

Income or loss realized by resident individuals or partnerships from an established business, or from the lease or rental of tangible personal property or real property, the situs of which is in another state, shall be allocated to the state in which the business or

property is located. Except, income of a resident individual or partnership, derived from personal services, is allocated to this State as provided in Section 12-6-2220(6).

However, in the case of a resident individual or partnership, conducting a business of a unitary or homogenous nature, partly within and partly without this State, such income or loss is apportioned in accordance with the provisions of Sections 12-6-2250 through 12-6-3360.

*Ellis v. S. C. Tax Comm'n*, 309 S.E.2d 761 (S.C. 1983) *Sourcing*

By reason of the "pass through" rule, the character of any item of income, gain, loss deduction or credit included in a partner's distributive share of gains and losses shall be the same as if such item was realized directly from the source from which realized or incurred by the partnership. In other words, each item of income, gain, [\*\*763] loss, deduction or credit is treated as if it were realized or incurred by the partner directly from the source without ever having passed through the partnership. If this were not the case, then partners in real estate or other business ventures could not take advantage of depreciation write-offs and other operating expenses or losses.

South Carolina Revenue Procedure #17- 2 *Withholding/Return*

Each partnership is generally required to withhold income taxes on a nonresident partner's share of South Carolina taxable income. For tiered partnerships, if the lower tier withholds on the income of its nonresidents, the upper tier partnership does not also withhold on that same income. The upper tier partnership would withhold on any other South Carolina sourced income on behalf of its nonresident partners.

For example, assume Partnership A (upper tier partnership) is a non-South Carolina partnership with two partners (one partner is a resident of South Carolina.) Partnership A owns an interest in Partnership B (lower tier partnership), a South Carolina partnership. Partnership A may claim credit for the amount withheld by the lower tier partnership on behalf of Partnership A. The credit will reduce the amount of any further nonresident withholding due, if any, from the upper tier partnership's other sources of South Carolina income

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## Tennessee

Tenn. Code Ann. § 67-4-2012 *Sourcing*

(a)(3) Except as otherwise provided in this part, for tax years ending on or after December 31, 2023, but before December 31, 2024, net earnings must be apportioned to this state by multiplying the earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus five (5) times the receipts factor, and the denominator of the fraction is seven (7).

(a)(4) Except as otherwise provided in this part, for tax years ending on or after December 31, 2024, but before December 31, 2025, net earnings must be apportioned to this state by multiplying the earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus eleven (11) times the receipts factor, and the denominator of the fraction is thirteen (13).

(a)(5) Except as otherwise provided in this part, for tax years ending on or after December 31, 2025, net earnings must be apportioned to this state by multiplying the earnings by the receipts factor only.

(a)(6) If the application of subdivision (a)(3), (a)(4), or (a)(5) to a tax year results in a lower apportionment ratio than under the application of the apportionment method in



subdivision (a)(2) as it applied to tax years ending before December 31, 2023, then a taxpayer may annually elect to apply the apportionment method in subdivision (a)(2) as it applied to tax years ending before December 31, 2023; provided, however, the election must result in a higher apportionment ratio for the tax year, and the taxpayer must have net earnings, rather than a net loss, for that tax year as computed under § 67-4-2006 . . .

(b) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period. For this purpose, "property" includes a taxpayer's ownership share of the real or tangible property owned or rented by any general partnership, or entity treated as a general partnership for federal income tax purposes, in which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its property factor only the real and tangible property owned or used by the limited liability company. "Property" also includes a taxpayer's ownership share of the real or tangible property owned or rented by any limited partnership, subchapter S corporation, limited liability company or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and, therefore, is not subject to Tennessee excise tax. The cost value or rental value of such property shall be determined from the books and records of the entity in which the taxpayer has an interest and such property shall be valued in accordance with subsection (c) . . .

(e) The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period. For this purpose, "compensation" includes a taxpayer's ownership share of the compensation of any general partnership, or entity treated as a general partnership for federal income tax purposes, in which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its payroll factor only the compensation attributed to the limited liability company. "Compensation" also includes a taxpayer's share of any specific compensation of any limited partnership, subchapter S corporation, limited liability company or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and which is not doing business in Tennessee and thus is not subject to Tennessee excise tax . . .

(g) The receipts factor is a fraction, the numerator of which is the total receipts of the taxpayer in this state during the tax period, and the denominator of which is the total receipts of the taxpayer everywhere during the tax period. For this purpose, "gross receipts" includes a taxpayer's ownership share of the gross receipts of any general partnership, or entity treated as a general partnership for federal income tax purposes, in which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its receipts factor only the gross receipts attributed to the limited liability company. "Gross receipts" also includes a taxpayer's ownership share of gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and thus is not subject to Tennessee excise tax.

Tennessee Revenue Ruling No. 06-06 (March 14, 2006) *Sourcing*

### **For Application of Franchise, Excise Tax Apportionment Formula Statutes to [LP2]**

If [LP2] also has tax nexus in another state(s), it will apportion its net earnings and net worth to Tennessee for franchise, excise tax purposes using the property, payroll compensation and receipts apportionment formula previously described.

In addition to its own property, payroll compensation and receipts, [LP2] will include in its apportionment formula for franchise, excise tax purposes, its ownership share of the property, payroll compensation and gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and thus is not subject to Tennessee franchise, excise tax.

### **Application of Franchise, Excise Tax Apportionment Formula Statutes to [LP1]**

The facts presented state that [LP1] has no Tennessee tax nexus. Therefore, it is not subject to franchise, excise tax and will not compute an apportionment formula.

### **Application of Franchise, Excise Tax Apportionment Formula Statutes to the Taxpayer**

If the Taxpayer also has tax nexus in another state(s), it will apportion its net earnings and net worth to Tennessee for franchise, excise tax purposes using the property, payroll compensation and receipts apportionment formula previously described.

In addition to its own property, payroll compensation and receipts, the Taxpayer will include in its apportionment formula for franchise, excise tax purposes, its ownership share of the property, payroll compensation and gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and that is not doing business in Tennessee and thus is not subject to Tennessee franchise excise tax.

This will include the following:

1. 100% of its own property, payroll compensation and receipts.
2. 49.49% of [LP1's] property, payroll compensation and receipts.
3. 49.49% of property, payroll compensation and gross receipts passed-through to [LP1] by any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the Taxpayer has an ownership interest, directly or indirectly through [LP1] and that is not doing business in Tennessee and thus is not subject to Tennessee franchise excise tax.

It is important to note that the Taxpayer's indirect ownership share (49.49% of 99%) of property, payroll compensation and receipts of [LP2] will be excluded from the Taxpayer's apportionment formula because, although the Taxpayer indirectly has an ownership interest in [LP2] through [LP1], [LP2] is doing business in Tennessee and is subject to Tennessee franchise, excise tax. Thus, none of [LP2's] property, payroll compensation and receipts are passed-through to the Taxpayer.

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## Texas

Tex. Tax Code Ann. § 171.106(a) *Sourcing*

Except as provided by this section, a taxable entity's margin is apportioned to this state to determine the amount of tax imposed under Section 171.002 by multiplying the margin by a fraction, the numerator of which is the taxable entity's gross receipts from business done in this state, as determined under Section 171.103, and the denominator of which is the taxable entity's gross receipts from its entire business, as determined under Section 171.105.

Tex. Tax Code § 171.1015 *Sourcing, Withholding/Return*

- (a) In this section, "tiered partnership arrangement" means an ownership structure in which any of the interests in one taxable entity treated as a partnership or an S corporation for federal income tax purposes (a "lower tier entity") are owned by one or more other taxable entities (an "upper tier entity"). A tiered partnership arrangement may have two or more tiers.
- (b) In addition to the tax it is required to pay under this chapter on its own taxable margin, a taxable entity that is an upper tier entity may include, for purposes of calculating its own taxable margin, the total revenue of a lower tier entity if the lower tier entity submits a report to the comptroller showing the amount of total revenue that each upper tier entity that owns it should include within the upper tier entity's own taxable margin calculation, according to the ownership interest of the upper tier entity.
- (c) This section does not apply to that percentage of the total revenue attributable to an upper tier entity by a lower tier entity if the upper tier entity is not subject to the tax under this chapter. In this case, the lower tier entity is liable for the tax on its taxable margin.
- (d) Section 171.002(d) does not apply to an upper tier entity if, before the attribution of any total revenue by a lower tier entity to an upper tier entity under this section, the lower tier entity does not meet the criteria of Section 171.002(d)(1) or (d)(2).
- (e) The comptroller shall adopt rules to administer this section.

34 Tex. Admin. Code § 3.591(e)(20) *Sourcing, Withholding/Return*

The net distributive income or loss from a passive entity that is included in total revenue is sourced to the principal place of business of the passive entity.

Texas Comptroller's Letter No. 202104018L (April 14, 2021) *Sourcing, Withholding/Return*

*Tiered Partnership Provisions*

**Can a lower tier entity exclude from total revenue the amount of total revenue that it reports to an upper tier entity under the tiered partnership provisions?**

Yes. However, a lower tier entity may not report total revenue to an upper tier entity if the upper tier entity is not subject to the franchise tax. (Texas Tax Code (TTC) 171.1015.)

**Are there any special reports that must be filed if the tiered partnership provision is used?**

Each entity (lower and upper tier) that is filing under the tiered partnership provision must submit, along with its franchise tax report, Form 05-175, Texas Franchise Tax Tiered Partnership Report, to show the amount of total revenue that each upper tier entity should include with the upper tier entity's own total revenue.

**Is an upper tier entity eligible for the E-Z computation or no tax due report?**

The no tax due thresholds and the E-Z computation do not apply to an upper or lower tier entity if, before the attribution of any total revenue by a lower tier entity to an upper tier entity, the lower tier entity does not meet the criteria.

**Do the tiered partnership provisions apply if some of the entities in the tiered partnership arrangement are part of a combined group?**

The tiered partnership provision is not available if the lower tier entity is included in a combined group.

**Do upper tiers and lower tiers have to have the same accounting period to make the tiered partnership election?**

No, but the revenue must be allocated to the accounting period on which the report is based.

**Is the tiered partnership election in TTC 171.1015 mandatory?**

No.

**Is the tiered partnership election in TTC 171.1015 an alternative to combined reporting?**

No. Combined reporting is mandatory for taxable entities that meet the ownership and unitary criteria. The tiered partnership provisions are not available if the lower tier entity is included in a combined group.

**If the tiered partnership election in TTC 171.1015 is made, does the lower tier partnership have to report all revenue to all upper tier entities?**

No, a lower tier entity that is not part of a combined group may choose to report total revenue to any or all of its upper tier entities. If the lower tier entity chooses to report total revenue to an upper tier entity, the lower tier entity must report total revenue to the upper tier entity according to the ownership interest of the upper tier entity. A lower tier entity may not report total revenue to an upper tier entity if the upper tier entity is not subject to the franchise tax.

34 Tex. Admin. Code § 3.590 *Sourcing, Withholding/Return*

(b)(2)(D) Eligible pass-through entities including partnerships, limited liability companies taxed as partnerships under federal law, limited liability companies that are disregarded under federal law and S corporations are included in a combined group . . .

(b)(2)(E) Passive entities are not included in the combined group; however, the pro rata share of net income from a passive entity shall be included in total revenue to the extent it was not generated by the margin of another taxable entity . . .

(b)(4)(A) Controlling interest means . . .

(ii) for a partnership, association, trust or other entity other than a limited liability company, more than 50%, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership, association, trust, or other entity

(iii) for a limited liability company, either more than 50%, owned directly or indirectly, of the total membership interest of the limited liability company or more than 50%, owned directly or indirectly, of the beneficial ownership interest in the membership interest of the limited liability company.

(b)(4)(B) Examples are as follows. . .

(iii) Individual A owns 100% of 10 corporations, each of which owns 10% of Partnership B. Individual A has a controlling interest in each of the ten corporations and in Partnership B.

(iv) Corporation A holds a 70% interest in Partnership B that owns 60% of Limited Liability Company C. Corporation A owns the remaining 40% of Limited Liability Company C. Corporation A owns a controlling interest in Partnership B and, taking into account Company A's direct and indirect ownership of Limited Liability Company C, a 100% controlling interest in Limited Liability Company C.

(v) Corporation A owns 10% of Limited Liability Company C and 45% of Corporation B, which owns 90% of Limited Liability Company C. Corporation A would hold a 10% interest in Limited Liability Company C which would not constitute a controlling interest. Corporation B has a controlling interest in Limited Liability Company C.

(vi) Partnership P is owned equally by Limited Liability Company A, Limited Liability Company B and Limited Liability Company C. Three unrelated individuals each wholly owns one of the limited liability companies. None of the limited liability companies owns more than 50% of Partnership P. There is no controlling interest.

(vii) Individual A and Individual B each owns 50% of Partnership X. Individual A and Individual B each also owns 50% of Partnership Y. Individual A and Individual B are not husband and wife. Since neither individual owns more than 50% of each partnership, neither individual has a controlling interest in the partnerships.

(b)(4)(F) Membership in more than one group. If an entity is a member of more than one affiliated group, the entity is treated as a member of the affiliated group (or part thereof) with respect to which it has a unitary relationship. If the entity has a unitary relationship with more than one of those affiliated groups, it shall elect to be treated as a member of only one group. The election shall remain in effect until the unitary business relationship between the entity and the other members ceases, or unless revoked with approval of the comptroller.

Tex. Tax Code § 171.0002 *Withholding/Return*

(a) Except as otherwise provided by this section, "taxable entity" means a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity. The term includes a combined group. A joint venture does not include joint operating or co-ownership arrangements meeting the requirements of Treasury Regulation Section 1.761-2(a)(3) that elect out of federal partnership treatment as provided by Section 761(a), Internal Revenue Code.

(b) "Taxable entity" does not include:

- (1) a sole proprietorship;
- (2) a general partnership:
  - (A) the direct ownership of which is entirely composed of natural persons; and
  - (B) the liability of which is not limited under a statute of this state or another state, including by registration as a limited liability partnership;
- (3) a passive entity as defined by Section 171.0003; or
- (4) an entity that is exempt from taxation under Subchapter B.

## Utah

### Utah Code Ann. § 59-10-1404 *Sourcing*

Regardless of whether or how an item of income, gain, loss, deduction, or credit is characterized for federal income tax purposes, that item of income, gain, loss, deduction, or credit is from the same source and incurred in the same manner for a pass-through entity taxpayer as if the item of income, gain, loss, deduction, or credit is:

- (1) realized directly from the source from which the item of income, gain, loss, deduction, or credit is realized by the pass-through entity; or
- (2) incurred in the same manner as incurred by the pass-through entity.

### Utah Code Ann. § 59-10-117(1)(d) *Sourcing*

a share of income, gain, loss, deduction, or credit of a nonresident pass-through entity taxpayer, as defined in Section 59-10-1402, derived from or connected with Utah sources shall be determined in accordance with Section 59-10-118 . . .

### Utah Code Ann. § 59-10-1402(6) *Sourcing*

"Derived from or connected with Utah sources" means:

- (a) if a pass-through entity taxpayer is classified as a C corporation for federal income tax purposes, derived from or connected with Utah sources in accordance with Chapter 7, Part 3, Allocation and Apportionment of Income - Utah UDITPA Provisions; or
- (b) if a pass-through entity or pass-through entity taxpayer is classified as an estate, individual, partnership, S corporation, or a trust for federal income tax purposes, derived from or connected with Utah sources in accordance with Sections 59-10-117 and 59-10-118.

### Utah Admin. Code R865-9I-13(1) *Sourcing*

(b) the nonbusiness income of the pass-through entity derived from or connected with Utah sources.

(i) "Nonbusiness income of the pass-through entity derived from or connected with Utah sources" does not include portfolio income if the income would not be reportable to Utah on the pass-through entity taxpayer's Utah state tax return or the Utah state tax return of any downstream pass-through entity taxpayer.

(ii) "Downstream pass-through entity taxpayer" means a pass-through entity taxpayer that is a pass-through entity taxpayer of any entity that is itself a pass-through entity taxpayer.

### Utah Admin. Code R865-6F-8(11)(f) *Sourcing*

Income or loss from partnership or joint venture interests shall be included in income and apportioned to Utah through application of the three-factor formula consisting of property, payroll and sales. For apportionment purposes, the portion of partnership or joint venture property, payroll and sales to be included in the corporation's property, payroll and sales factors shall be computed on the basis of the corporation's ownership interest in the partnership or joint venture, and otherwise in accordance with other applicable provisions of this rule.

Utah State Tax Commission Website FAQs – 2022 House Bill 444 – Federal State and Local Tax Deduction Workaround *PTE*

**If you have tiered pass-through entities (an LLC owned by other LLC's for example) does the payment of tax place at the top of the tier or at each level?**

A PTE may only make the election for its directly related members who are taxed as individuals. In a tiered series of PTEs, only the PTE who has the individual as a member may make the election. The election may NOT be made by a PTE for income that will pass through to another PTE before getting to a Final PTET.

Form TC-65 Utah Instructions (2023) *Sourcing, PTE, Withholding/Return*

**Upper-tier Pass-through Entity.** An upper-tier pass-through entity is a pass-through entity in which this partnership has an ownership interest and from whom this partnership receives an allocation of income, gain, loss, deduction, or credit on a Utah Schedule K-1 . . .

If a partnership has an interest in another partnership, that upper-tier partnership must withhold Utah income tax on Utah income allocated to the lower-tier partnership. The upper-tier partnership must provide a Utah Schedule K-1 showing the amount of Utah withholding tax paid on behalf of the lower-tier partnership. The lower-tier partnership must report this withholding tax on form TC-250 and then allocate it to its partners, who will claim the withholding tax on their returns. Enter this previous pass-through entity withholding tax for each partner on Schedules K and K-1 . . .

If a corporation holds direct and indirect ownership interests in tiered pass-through entities, it must include its pro rata share of the apportionment factors (property, payroll and sales) of the pass-through entities, applying the respective ownership percentages. For example, a corporation that holds 50 percent interest in Partnership A that in turn holds 20 percent interest in Partnership B would include 50 percent of the factors of Partnership A, and 10 percent (50 percent of 20 percent) of the factors of Partnership B . . .

If this partnership owns an interest in another pass-through entity, that pass-through entity must withhold Utah income tax on any income attributable to this partnership. The pass-through entity must provide a Utah Schedule K-1 showing the amount of Utah withholding paid on behalf of this partnership. This partnership then distributes the credit for the pass-through entity withholding tax to its partners. Complete TC-250, Part 2, and then enter and allocate the total upper-tier (previous) pass-through entity withholding tax using code 36. Do not include Utah Schedule K-1 the partnership received showing this credit when filing this partnership's return . . .

Enter the amount of any pass-through entity withholding tax paid by an upper-tier (previous) pass-through entity, attributable to this partnership, and allocated to the pass-through entity taxpayer. The credit for upper-tier pass-through entity withholding tax reduces the amount of Utah withholding tax calculated for this partner on Schedule N. Also report the credit on line 19 of Schedule K-1 for this partner . . .

Utah Code Ann. § 59-10-1403.2(1)(a) *Withholding/Return*

Except as provided in Subsections (1)(b) and (2), for a taxable year, a pass-through entity shall pay or withhold a tax:

(i) on:

- (A) the business income of the pass-through entity; and
- (B) the nonbusiness income of the pass-through entity derived from or connected with Utah sources; and

(ii) on behalf of a pass-through entity taxpayer.

Utah Publication 68 (06/2023) *Withholding/Return*

A pass-through entity that has another pass-through entity as a partner, member, shareholder or beneficiary is called a first tier or upper-tier entity. The partner, member, shareholder or beneficiary is a second tier entity or a downstream entity. A pass-through entity is directly related to a pass-through entity taxpayer if they occupy consecutive tiers.

For example, a first tier entity is directly related to a second tier entity. A second tier entity is directly related to a third tier entity. A first tier entity is not directly related to a third tier entity. Application of these rules is discussed in some of the following examples . . .

Partnership B has Utah business income and two partners who are both partnerships. Partnership B is a first tier entity. Partner #1, a partnership, has a partner that is a REIT. Partner #2 is a partnership whose partners are all Utah resident individuals. Partners #1 and #2 are both second tier entities. Partnership B must withhold Utah tax for both of its partners, even though a partner of one of its partners (a third tier entity) is a REIT. Partnership B and the REIT are not directly related. Partnership B is only exempt from the withholding requirement if a directly related pass-through entity taxpayer is a REIT, an individual Utah resident, or otherwise exempt.\*

An individual exempt from Utah income tax under Utah Code §59-10-104.1 is exempt from pass-through entity withholding from the pass-through entity to whom they are directly related . . .

Partnership B has a partner that is a family partnership with some nonresident individuals who meet the exemption from Utah income tax. Partnership B must withhold Utah income tax for that partner.\* Partnership B, the first tier partner, is not directly related to the partners of the second tier family partnership . . .

A pass-through entity taxpayer that is a pass-through entity taxpayer of any entity that is itself a pass-through entity taxpayer. The first pass-through entity is the first tier entity, its pass-through entity taxpayers are second tier entities, any pass-through entity taxpayers of the second tier entities are third tier entities and so on

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## Vermont

### Vt. Stat. Ann. tit. 32, § 5920(a) *Sourcing*

A partnership or limited liability company, which engages in activities in Vermont that would subject a C corporation to the requirement to file a return under section 5862 of this title, shall file with the Commissioner an annual return, in the form prescribed by the Commissioner, on or before the due date prescribed for the filing of the entity's federal return. The return shall set forth the name, address, and Social Security or federal identification number of each partner or member; the partnership or limited liability company income attributable to Vermont and the income not attributable to Vermont with respect to each partner or member as determined under this chapter; and such other information as the Commissioner may by rule prescribe. The partnership or limited liability company shall, on or before the day on which such return is filed, furnish to each person who was a partner or member during the year a copy of such information shown on the return as the Commissioner may by rule prescribe.

### Vt. Code R. § 10 060 040 [REG. Section 1.5862(d)] *Sourcing*

Section 4(b)(4) Pass-through entities, including partnerships, limited liability companies taxed as partnerships under federal law, and S corporations are not themselves members of the affiliated group. However, a pro rata share of such entity's income and



sales, payroll and property is assigned to the unitary group member that holds an ownership interest in such pass-through entity . . .

Section 4(d)(2) voting stock owned by a partnership, other than a limited partnership, is indirectly owned by a partner in proportion to the partner's capital interest in the partnership. For this purpose, a partnership other than a limited partnership is treated as owning proportionately the stock owned by any other partnership or limited partnership in which it has a tiered interest. Voting stock owned by a limited partnership is indirectly owned by the general partner who has authority to determine how the stock is voted . . .

Section 7(d)(2) the taxpayer member's apportionment percentage, determined under Reg. § 1.5833. including in the numerator the taxpayer's property, payroll and sales associated with the combined group's unitary business in Vermont, and including in the denominator the property, payroll and sale of all members of the combined group, including the taxpayer, which property, payroll and sales are associated with the combined group's unitary business wherever located. The property, payroll and sales of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of the partnership's unitary income included in the income of the combined group in accordance with (e)(3) . . .

Section 7(e)(3) If the unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business income . . .

#### Draft Changes for Reg. §1.5862(d) *Sourcing*

Ex. 2) Same facts as Example 1, but Office Co. enters into an agreement to purchase a 30% interest in Partnership P. The partnership agreement provides that Office Co.'s income distribution from P is also 30%. P is used as Office Co. and Insurance Co.'s main supplier of paper. P engages in unitary activities with the affiliated group. Office Co. is imputed to have engaged in the activities of P. The pro rata net income of P must be included in the combined report as well as the net income of Insurance Co. The pro rata share of apportionment factors of P should be included in Office Co.'s data according to the percentage of income distributed . . .

A unitary business includes that part of the business that meets the definition in this Section 5(a) and is conducted by a taxpayer through the taxpayer's interest in a partnership, whether the interest in that partnership is held directly or indirectly through a series of partnerships or other pass-through entities.

#### Vermont Formal Ruling No. 88-18 (January 6, 1989) *Sourcing*

You have requested a formal ruling on the application of Vermont's tax laws to partnership income earned by a corporation. This letter relies on representations contained in your letter dated [Date].

Corporation A is an Illinois corporation which owns and operates movie theaters within and without Illinois. Corporation A is a 50% general partner in Partnership Z which owns and operates several theaters in the State of Vermont. Corporation A and Partnership Z are unitary in all respects other than ownership.

The question is whether Corporation A's partnership income is to be reported as business or nonbusiness income and further if the income is to be reported as business income by Corporation A, whether this income is apportioned by Corporation A on the basis of its own apportionment factors or whether the apportionment factors of the partnership are also used.

The same questions are asked assuming Corporation A is a limited partner in Partnership Z and does not participate in the management of Partnership Z.

Because a partnership is not a taxable entity, but is rather an aggregate of distinct partners, each partner is considered as directly conducting the business and owning the assets of the partnership in the state. Thus, income and losses flow through to the partners and are reported on the partners' returns. However, the tax character of any item is determined at the partnership level. IRC § 702(b) provides that the character of any item of income, gain, loss, deduction or credit included in a partner's share shall be determined as if such item were realized by the partnership or incurred in the same manner as incurred by the partnership.

Partnership Z owns and operates theaters in Vermont. The partners thereof are deemed to be conducting this business and are therefore within the taxing jurisdiction of the state. The result does not change where Corporation A is a limited partner in Partnership Z. In either case, the partnership is merely a conduit for business income taxable to the partners.

For Vermont income tax purposes, a corporation's apportionable income is its federal taxable income, with certain adjustments not relevant here. 32 V.S.A. §§ 5811(18), 32 V.S.A. §5833. Vermont statutes are otherwise silent as to the treatment of a corporate partner and specifically as to whether the partnership apportionment factors are to be reflected in those of the corporate partner.

A partnership is not a separate tax-paying entity. Partners are required to report their share of each item of partnership income or loss regardless of whether the partnership makes actual distributions to them. IRC Sec. 702(a). Since partnership income (loss), generated by partnership sales, payroll and property, is included in the corporate partner's income, it follows that the partnership apportionment factors should be reflected in the denominator of the corporate partner's apportionment formula. Stated otherwise, each partner is treated as paying its proportionate share of partnership payroll, incurring its share of partnership depreciation and receiving its share of partnership sales, and these items also should be reflected in the partner's apportionment factors. Thus, to the extent that partnership income is reported by the corporation, the partnership's apportionment factors should also be reflected.

#### Vermont Instructions to Schedule BA-402 (2023) *Sourcing*

If this entity holds an interest in a unitary pass-through entity, then the pro-rata share of the passthrough entity's apportionment factors must be added to Lines 3 through 12. If the pass-through entity is not unitary then the distributed income is reported on Lines 1A and 1B, and the pro-rata share of pass-through entity's apportionment factors are excluded from Lines 2 through 20.

#### Vt. Stat. Ann. tit. 32, § 5920(h) *Withholding/Return*

(3) A lower-tier pass-through entity of a publicly traded partnership may request from the Commissioner an exemption from the compliance and payment obligations specified in subsections (b) and (c) of this section. The request for the exemption must be in writing and contain:

(A) the name, the address, and the account number or federal identification number of each of the lower-tier pass-through entity's partners, shareholders, members, or other owners; and

(B) information that establishes the ownership structure of the lower-tier pass-through entity and the amount of Vermont source income.

(4) The Commissioner may request additional documentation before granting an exemption to a lower-tier pass-through entity. As used in this subsection, a "lower-tier pass-through entity" means a pass-through entity for purposes of the Internal Revenue Code, which can include a partnership, S corporation, disregarded entity, or limited liability company and which allocates income, directly or indirectly, to a publicly traded partnership. The exemption under subdivision (3) of this subsection shall only apply to income allocated, directly or indirectly, to a publicly traded partnership.

(5) If granted, the exemption for the lower-tier pass-through entity shall be effective for three years following the date the exemption is granted. At the end of the three-year period, the lower-tier pass-through entity of a publicly traded partnership shall submit a new exemption request to continue the exemption. The Commissioner may revoke the exemption for the lower-tier pass-through entity if the Commissioner determines that the lower-tier pass-through entity is not satisfying its tax payment and reporting obligations to the State with respect to income allocated, directly or indirectly, to non-resident partners or members that are not publicly traded partnerships.

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## Virginia

### Va. Code Ann. § 58.1-391(B) *Sourcing*

Each item of pass-through entity income, gain, loss or deduction shall have the same character for an owner under this chapter as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for an owner as if realized directly from the source from which realized by the pass-through entity or incurred in the same manner by the pass-through entity.

### Virginia Ruling of the Commissioner PD 15-240 (April 26, 2007) *Sourcing*

If the entire business of a pass-through entity is not deemed to have been transacted or conducted within the Commonwealth, then "income from Virginia sources" means that portion of the pass-through entity's income that has been allocated and apportioned to Virginia in the same manner as corporations.

### Virginia Ruling of the Commissioner PD 07-50 (April 26, 2007) *Sourcing*

A partnership (the "Partnership"), located in \*\*\*\*\* (State A), has two 50% equity partners. The general partner is an individual who resides in \*\*\*\*\* (State B). The limited partner is a State B corporation. The partnership purchased commercial property in Virginia under a triple net lease. Neither the partnership nor the partners conduct any other business in Virginia other than the ownership of the Virginia commercial property. You request a ruling as to whether any of the parties are required to file Virginia income tax returns.

Virginia Code § 58.1-392 requires every pass-through entity doing business in Virginia or having income from Virginia sources to file an annual information return with the Department of Taxation setting forth its income and a list of owners, effective for taxable years beginning on or after January 1, 2004. Pursuant to Va. Code § 58.1-302, an entity has income from Virginia sources if it has any income, gain, loss or deduction attributable to the ownership in real property located in Virginia. As such, because the Partnership owns income-producing real property in Virginia, it must file an informational return.

Public Law (P.L.) 86-272, codified at 15 U.S.C. §§ 381-384, prohibits a state from imposing a net income tax where the only contacts with a state are a narrowly defined set of activities constituting solicitation of orders for sales of tangible personal property. The

Department also applies P.L. 86-272 to the solicitation of sales of other than tangible personal property. See Public Document (P. D.) 93-75 (3/17/93). The Department limits the scope of P.L. 86-272 to only those activities that constitute solicitation, are ancillary to solicitation, or are de minimis in nature. See Wisconsin Department of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). The Partnership's ownership of commercial property in Virginia clearly exceeds the protection provided by P.L. 86-272.

Virginia generally conforms to the federal treatment of partnerships. A partnership, as such, is not subject to income tax. Any income tax arising from the income of the partnership is the liability of the partners. Internal Revenue Code § 702(b) states, "The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share . . . shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership." Each item of pass-through entity income, gain, loss or deduction has the same character for an owner for Virginia income tax purposes as for federal income tax purposes. See Va. Code § 58.1-391 B.

Thus, if a partnership operates a business in Virginia, any item of partnership income, gain, loss, deduction, or credit will retain its Virginia source character no matter how many partnerships it passes through. The pass through of Virginia source income will continue to occur from partnership to partner until the income is passed through to a partner that is a taxable entity.

In the situation you present, the income generated by the commercial property will retain its character as Virginia source income and pass through to both the general and limited partners, which are taxable entities. As such, the general partner will need to file a nonresident Virginia individual income tax return and the limited partner will need to file a Virginia corporate income tax return apportioning income in accordance with Va. Code §§ 58.1-408 through 58.1-421. See Public Document (P.D.) 88-165 (6/29/88).

This ruling is based on the facts presented as summarized above. Any change in facts or the introduction of new facts may lead to a different result.

The Code of Virginia sections and public document cited are available on-line at [www.tax.virginia.gov](http://www.tax.virginia.gov) in the Tax Policy Library section of the Department's web site. If you have any questions regarding this ruling, please contact \*\*\*\*\* in the Office of Policy and Administration, Appeals and Rulings, at \*\*\*\*\*.

#### Virginia Ruling of the Commissioner PD 19-114 (October 4, 2019) *Sourcing*

The Taxpayer was a corporation headquartered and domiciled in \*\*\*\*\* (State A) that operated refineries. It owned a 17% interest in \*\*\*\*\* (PLLC), a limited liability company treated as a partnership for federal income tax purposes that operated retail stores.

The Taxpayer included the apportionment factors of PLLC in its Virginia corporate income tax calculations and apportioned PLLC's income to Virginia. The Taxpayer subsequently filed amended returns for refund, removing PLLC's apportionment factors and allocating its income outside of Virginia. Under review, the Department denied the refunds because the Taxpayer owned more than 10% of PLLC. The Taxpayer appeals the denial of the refunds, contending that it should be allowed to allocate the income generated by PLLC because its ownership interest was a mere investment.

The Department has previously ruled that a corporation that holds a general partnership interest in a partnership must include its proportionate share of partnership property, payroll and sales in its own factors for purposes of apportioning Virginia taxable income. See Public Document (P.D.) 88-226 (7/12/1988).

In P.D. 95-19 (2/13/1995), the Department expanded this ruling to include a limited partner, unless all of the following tests are met: (1) a corporation holds a limited partnership interest; (2) all general partners are unrelated third parties; (3) the combined partnership interests held by the corporation and all related parties constitute 10% or less of the profit and capital interest of the limited partnership; and (4) the structure is not a device primarily designed to avoid Virginia taxation of the limited partnership's income. The corporate limited partner in P.D. 95-19 failed the test because the general partner was another corporation in the same affiliated group and the two corporations owned 100% of the partnership interests combined. Accordingly, the Department held that the limited partner in P.D. 95-19 was subject to Virginia income tax even though it had no other connection to Virginia other than its interest in the limited partnership.

The Taxpayer contends that its investment in PLLC was a passive investment in a limited liability company because it held a minority number of seats on PLLC's Board of Managers. In addition, the Taxpayer did not participate in the day-to-day management of PLLC and did not share any of its corporate functions such as marketing, purchasing, accounting and legal. Further, the Taxpayer had no authority to unilaterally bind the limited liability company during the taxable years at issue. The Taxpayer argues that its limited role with PLLC is analogous to a limited partnership interest. As such, it should not be required to apportion PLLC's income in accordance with P.D. 95-19.

Under Treasury Regulations § 301.7701-1 et seq., labeled "check the box" regulations, entities are permitted to choose a federal classification or be classified under the regulation's default provisions. If a limited liability company elects to be treated as a pass-through entity for federal income tax purposes, it is required to file a partnership return pursuant to IRC § 761.

A limited liability company, however, is different from a partnership. It shares characteristics of both partnerships and corporations. Like a partnership, a limited liability company is deemed to be a pass through entity that passes its profits and losses through to its members. Unlike a partnership, a limited liability company is a separate legal entity, distinct from its members and has full powers to conduct business in its own name. Limited liability companies are created by statute while partnerships are created by common law. As a legal entity separate from its members, a limited liability company will generally be considered to be operating as a business. Therefore, a limited liability company that passes through its income to its members is merely electing to have its business income taxed in a different manner.

A limited liability company can be managed by its members or by a manager designated by its members. The Taxpayer appears to assert that PLLC is managed by other members or by a management team, and its interest should be treated as if it was a limited partner. The United States Tax Court has distinguished between manager members and other members of LLCs, but defers to state law to distinguish between limited liability companies and partnerships. See *Paul D. Garnett, et ux. v. Commissioner*, 132 TC 368 (2009). Thus, the mere fact that PLLC files federal partnership returns does not automatically make the Taxpayer a limited partner eligible for treatment under P.D. 95-19.

Pursuant to Virginia Code § 13.1-1022 A, the management of a limited liability company in Virginia is vested in its members unless the articles of incorporation or an operating agreement provides for the management by a manager or managers. Limited partners in a limited partnership do not participate in the management of the enterprise unless a partnership agreement grants the right to vote upon business matters. See Virginia Code § 50-73.23 and *First Union Nat'l Bank v. Allen Lorey Family L.P.* 34 Va. Cir 474 (1994).

In Virginia, members of a limited liability company run by a manager are similar to limited partners in that they have a restricted role in the conduct of the limited liability company's business. Limited liability company managing members have a fiduciary

duty to act in good faith to the limited liability company, but not to the other members. See *Credit Experts, LLC v. Santos* (In re Santos), 2012 Bankr. LEXIS 3076 (Bankr. E.D. Va. 2012).

Under Virginia Code § 50-73.29 A, a general partner of a limited partner has the same rights and powers of a partner in a partnership without limited partners. In addition to the fiduciary duties a general partner owes to a partnership, they are also responsible for the duty of loyalty and care to other partners, whether limited or not. See Virginia Code § 50-73.102

As a result of the differences under Virginia law, the Department has concluded that, although limited liability companies are treated as partnerships for purposes of determining federal adjusted gross income, the election to have the income passed through to its members more closely resembles the treatment of shareholders in an S corporation. See P.D. 07-70 (5/18/2007). As such, the Department does not distinguish between members of a member managed limited liability company and a manager managed limited liability company.

For federal income tax purposes, attributes and activities of the PLLC will flow through to the Taxpayer. Further, the Department considers a taxpayer to be the owner of a share of the pass-through entity's assets and liabilities. See P.D. 97-343 (8/28/1997). Virginia Code § 58.1-391 B provides:

Each item of pass-through entity income, gain, loss or deduction shall have the same character for an owner under this chapter as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for an owner as if realized directly from the source from which realized by the pass-through entity or incurred in the same manner by the pass-through entity.

Pass-through entities that have income from activity both within and without Virginia are required to compute their Virginia source income in accordance with the corporate statutory formula set forth in Virginia Code §§ 58.1-408 through 58.1-421. As such, pass-through entities generally must allocate dividends to the state of commercial domicile and apportion all other income. Income is apportioned using a three-factor formula based on the property, payroll and sales within Virginia. See P.D. 88-165 (6/29/1988) and P.D. 07-150 (9/21/2007). Therefore, the Taxpayer will include income or loss of PLLC in determining Virginia taxable income and the appropriate amount of PLLC's property, payroll and sales in determining income apportioned to Virginia.

#### Alternative Method of Apportionment

If the entire business of the pass-through entity is not deemed to have been transacted or conducted within Virginia, then such pass-through entity's income from Virginia sources is the portion of income allocated and apportioned to Virginia in the same manner as corporations. See P.D. 07-150 (9/21/2007).

Accordingly, LLCs that have income subject to tax in Virginia and at least one other state are required to apportion income as provided in Virginia Code §§ 58.1-408 through 58.1-421. The Code of Virginia does not provide for the allocation of income other than certain dividends. Accordingly, a taxpayer's entire federal taxable income, adjusted and modified as provided in Virginia Code §§ 58.1-402 and 58.1-403, less dividends allocable pursuant to Virginia Code § 58.1-407, is subject to apportionment. The Taxpayer's protest has been treated as a request for an alternative method of allocation and apportionment in accordance with Virginia Code § 58.1-421.

In any proceeding with the Department, the Taxpayer bears the burden of showing that the imposition of Virginia's statute is in violation of the standards enunciated by the United States Supreme Court in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504

U.S. 768, 119 L.Ed.2d 533 (1992) and clarified in *Meadwestvaco Corporation v. Illinois Department of Revenue*, 553 U.S. 16, 128 S.Ct. 1498 (2008). In order to meet the standards set by the United States Supreme Court, a taxpayer must demonstrate that its investments are not operational assets involved in a unitary business.

In considering the existence of a unitary relationship, the United States Supreme Court has focused on three objective factors: (1) functional integration; (2) centralization of management; and (3) economies of scale. See *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *F. W. Woolworth Co. v. Taxation and Revenue Dept. of N.M.*, 458 U.S. 352 (1982); and *Allied-Signal*.

The decision of the United States Supreme Court in *Allied-Signal* also made it clear that the payee and payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. In *Meadwestvaco supra* at 29, 128 S.Ct. 1507, the Supreme Court clarified that the decision in *Allied-Signal* did not create “a new ground for the constitutional apportionment of extrastate values in the absence of a unitary business.” Still, it opined the operational function analysis in *Allied-Signal* could be influential to the finding that an asset was a unitary part of a business being conducted in the taxing jurisdiction. Accordingly, the form of an entity's business and the purpose of its investments are both relevant in determining if an asset was a unitary part of the business conducted by such entity.

As indicated above, Virginia Code § 58.1-391 B provides “[e]ach item of pass-through entity income, gain, loss or deduction shall have the same character for a partner under this chapter as for federal income tax purposes.” For Virginia income tax purposes, income retains its character as income from the operations of a pass-through entity in computing Virginia taxable income and is properly included in the apportionable income of the shareholder. This means that, for income tax purposes, the owners are considered to be reporting the operating income of the business conducted by the pass-through entity. As such, the Department generally presumes that the income passed through from a pass-through entity to be operational. See P.D. 07-197 (11/30/2007).

The Taxpayer contends that P.D. 93-140 (6/4/1993) and *7-Eleven, Inc. f/k/a the Southland Corporation v. Comptroller of the Treasury, Court of Special Appeals of Maryland*, No. 1661 (6/13/2001) are applicable to its case. Both P.D. 93-140 and *Southland Corporation* can be distinguished from the Taxpayer's facts because the income at issue resulted from the sale of assets. In this case, the Taxpayer received income from the operations of PLLC, not from the sale of its interest in PLLC.

In P.D. 07-197, the income generated by investments in stocks, bonds, and limited partnership interests made by a partnership formed by a group of corporate taxpayers was considered an investment, rather than operational income. The Department's rationale is that the assets and income of the partnership were not used to supplement or enhance the operations of the group. In P.D. 07-118 (7/19/2007), however, a pass-through entity that was a member of another pass-through entity that operated a hotel was required to include the hotel's apportionment factors in its Virginia taxable income. The Department determined that the characteristics as an operator of the hotel would flow through to the Taxpayer.

In P.D. 07-197, the income was generated by passive investments in stocks, bonds and limited liability companies whereas in P.D. 07-118, the investment was in a pass-through entity that actually operated a business. In this case, PLLC operates a retail business. Therefore, the characteristics of the operator of the retail business would flow through to the Taxpayer. Because it is considered to be operating a retail business for income tax purposes, PLLC is considered to be a unitary part of the Taxpayer's business.

## CONCLUSION

Because the Taxpayer's interest in PLLC was greater than 17%, its interest in PLLC does not qualify for the factor exclusion permitted by PD 95-19. In addition, the Taxpayer has not demonstrated that its ownership interest in PLLC was not a unitary part of its business operations. Because it has failed to provide clear and convincing evidence that an alternative method of allocation and apportionment is appropriate, the Taxpayer's request for a refund for the taxable years ended December 31, 2013 through 2015 is not granted.

The Code of Virginia sections and public documents cited are available on-line at [www.tax.virginia.gov](http://www.tax.virginia.gov) in the Laws, Rules & Decisions section of the Department's web site. If you have any questions regarding this determination, you may contact \*\*\*\*\* in the Office of Tax Policy, Appeals and Rulings, at \*\*\*\*\*.

#### The Virginia Form 502 Instructions (2023) *Sourcing*

If a PTE's entire business is conducted within Virginia, then all of its income is Virginia source income; no income is allocated to another state, and the entity's Virginia apportionment is 100%. If a PTE conducts its business in Virginia and elsewhere in a manner such that its income would be subject to a tax on net income in Virginia and at least one other state, the entity must allocate and apportion its income in the same manner that is provided in Virginia law for corporations. This applies to all types of pass-through entities (partnerships, LLPs, LLCs, and S corporations). Dividends received are to be allocated to the state of commercial domicile, but all other income must be apportioned. An entity may not apportion its income based on divisional or separate accounting, or any other alternate method unless it has requested and received permission to do so in advance from the Department.

The effect of the PTE's apportionment may vary from one owner to another, depending on the entity types of the owners. For instance:

- a Virginia resident individual owner is taxable on all of his or her PTE income regardless of the entity's apportionment;
- a nonresident individual owner uses the entity's Virginia apportioned income in determining his or her own Virginia nonresident percentage; and
- a corporate owner may need to include the PTE's property, payroll, and sales factors in determining its own apportionment percentage.

#### Virginia Guidelines for the Pass-through Entity Tax *PTE*

In determining the share of such income or loss that is attributable to Virginia, the electing PTE adds:

- Each nonresident eligible owner's share of such income or loss other than dividend income ("apportionable income") multiplied by the PTE's apportionment percentage; and
- Each nonresident eligible owner's share of dividend income ("allocable income") if the PTE is commercially domiciled in Virginia.

#### Va. Code Ann. § 58.1-392(A) *Withholding/Return*

Every pass-through entity doing business in Virginia, or having income from Virginia sources, shall make a return to the Department of Taxation on or before the fifteenth day of the fourth month following the close of its taxable year. Such returns shall be made and filed in the manner prescribed by the Department.

#### Virginia Ruling of the Commissioner PD 15-240 (December 22, 2015) *Withholding/Return*



If a pass-through entity (the “upper-tier entity”) owns another pass-through entity (the “lower-tier entity”), the lower-tier entity should not withhold on the Virginia income allocable to the upper-tier entity. Rather, an upper-tier entity must file Form 502 (and any accompanying schedules and documentation) on its own behalf to reflect any income attributable to the lower-tier entity. The upper tier entity must either pay the pass-through entity withholding tax on income allocable to its nonresident owners for income received from the lower-tier entity or file Form 765 on behalf of such nonresident owners. In cases where there are more than two tiered pass-through entities, the tax must be withheld by the highest tiered entity . . . Each pass-through entity in a tiered pass-through entity structure is required to make its own determination as to which method of apportionment to use.

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## West Virginia

### W. Va. Code § 11-21-17(b) *Sourcing*

Each item of partnership income, gain, loss, or deduction shall have the same character for a partner under this article as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

### W. Va. Code § 11-21-37 *Sourcing*

(a) In determining West Virginia source income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with West Virginia sources of such partner's distributive share, for federal income tax purposes, of items of partnership income, gain, loss and deduction, as such portion shall be determined under regulations of the tax commissioner consistent with the applicable rules of section thirty-two [§ 11-21-32].

### W. Va. Code § 11-21-37A *Sourcing*

(a) Notwithstanding any provision of §11-21-37 of this code to the contrary, a business doing business in West Virginia and in one or more other states shall allocate its non-business income as provided in §11-21-37a(c) of this code and shall apportion its business income as provided in §11-21-37a(f) of this code to determine the West Virginia source income of its nonresident partners and nonresident S corporation shareholders for purposes of this article. For purposes of this section:

(1) The term "business entity" includes a partnership, limited partnership, joint venture, corporation, S corporation, and any other group or combination acting as a unit, but does not include a sole proprietorship; and

(2) The term "engaging in business" or "doing business" means any activity of a business entity which enjoys the benefits and protection of government and laws in this state. . . .

(j)(A) Allocation and apportionment on and after January 1, 2022. - For tax years beginning on and after January 1, 2022, income of flow-through entities allocated and apportioned under this section and §11-21-32 of this code, shall be allocated and apportioned in the same manner and to the same extent as the income of corporations and entities taxable under §11-24-1 et seq. of this code are allocated and apportioned under §11-24-7 of this code. Apportioned income shall be apportioned pursuant to application of a single sales factor to the same extent as the income of corporations and entities taxable under §11-24-1 et seq. of this code are apportioned under §11-24-7 of this code.

Allocated income shall be allocated in the same manner and to the same extent as the income of corporations and entities taxable under §11-24-1 et seq. of this code are apportioned under §11-24-7 of this code.

(B) For purposes of this article the provisions of §11-21-12K, §11-21-37b and §11-21-37c of this code remain unchanged by this section.

(C) For purposes of this article, "flow-through entity", "conduit entity" or "pass through entity" means an S corporation, partnership, limited partnership, limited liability partnership, or limited liability company. The term "flow-through entity," "conduit entity" or "pass through entity" includes a publicly traded partnership as that term is defined in section 7704 of the Internal Revenue Code that has equity securities registered with the Securities and Exchange Commission under Section 12 of Title I of the Securities Exchange Act of 1934, 15 USC 78l .

(D) Allocation of flow-through income to recipients. - Income of a flow-through entity allocated and apportioned under this section or any other provision of this article is allocated income in the hands of a shareholder, interest owner, partner, member or other recipient of flow-through income, and taxable to such recipient as income allocated to this state under the provisions of this article, or in the case of recipients of such flow through income that are taxable under the provisions of §11-24-1 et seq. of this code, such income is taxable to such recipient as income allocated to this state under the provisions of §11-24-1 et seq. of this code.

#### W. Va. Code § 11-24-7(d)(5) *Sourcing*

(A) Persons carrying on business as partners in a partnership, as defined in Section 761 of the Internal Revenue Code of 1986, as amended, are liable for income tax only in their separate or individual capacities.

(B) A corporate partner's distributive share of income, gain, loss, deduction or credit of a partnership shall be modified as provided in section six of this article for each partnership. For taxable years beginning on or after December 31, 1998, the distributive share shall then be allocated and apportioned as provided in this section using the partnership's property, payroll and sales factors. The sum of that portion of the distributive share allocated and apportioned to this state shall then be treated as distributive share allocated to this state; and that portion of distributive share allocated or apportioned outside this state shall be treated as distributive share allocated outside this state, unless the taxpayer requests or the Tax Commissioner, under subsection (h) of this section requires that the distributive share be treated differently.

(C) This subdivision shall be null and void and of no force or effect for tax years beginning on or after January 1, 2009.

#### W. Va. Code § 11-24-13C *Sourcing*

(c)(2) The property, payroll and sales of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group in accordance with section thirteen-d of this article and the denominator of which is the amount of the partnership's total unitary income.

#### W. Va. Code R. § 110-24-6 Example 3 *Sourcing*

When a partnership owned in part by a corporation has taxable nexus in one or more states into which the corporation sells tangible personal property, but the corporation does not otherwise have taxable nexus with those states. A combined group engaged in unitary business activity consists of Corporations A, B, C and D. The combined group

makes sales to customers in States 1, 2, 3, 4, 5 and 6. However, Corporations A and C do not sell tangible personal property to customers in all of those states or, in some of the states, Corporations A and C are not subject to an income tax because of application of Public Law 86-272. Corporations A and C each own an interest in partnerships engaged in unitary business activity with the combined group. These partnerships have taxable nexus with states into which Corporations A and C sell tangible personal property and in which Corporations A and C do not have taxable nexus if their partnership interests are disregarded. Each corporation's share of sales reflected in the apportionment factors of the partnerships are included in the apportionment factors of Corporation A and C, which are the corporate owners of the partnerships. As a consequence, all members of the combined group have taxable nexus with all of the states into which they sell tangible personal property, and the no throw does not apply to this combined group.

#### West Virginia Form PTE-100 Instructions *Sourcing*

Pass through entity owners of pass through entities should allocate income received from a Pass Through Entity unless such entities are engaged in a unitary business. If a unitary relationship exists, a Pass Through Entity owner of a pass through entity may reapportion its WV income, including the appropriate factors of the subsidiary.

#### West Virginia Taxpayer Services Division Publications No. TSD-392 (May 1, 2020) *Sourcing*

A corporate partner's distributive share of partnership income, gain, loss, deduction or credit is apportionable to West Virginia. State law presumes that a corporate partner's distributive share of partnership income is apportionable business income.

#### West Virginia Tax Division Website *PTE*

The elective pass-through entity tax is a tax imposed directly upon the income of the entity, defined as the resident pass-through entity owners' income plus the apportioned nonresident pass-through entity owners' income. The pass-through entity tax is filed and paid instead of the nonresident withholding due with PTE-100 . . .

Tiered partnerships are eligible to file the EPT election. After an EPT Return has been filed and any amounts due paid, the electing entity should issue an EK-1 to their partners. EK-1 should not report withholding of the partner. EK-1 is to report the credit available to the partner/shareholder which was created because of the withholding. Individual partners will need to include the EK-1 with their IT-140 when they file to claim the income credit. The income credit is claimed on the Recap Schedule.

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## Wisconsin

#### Wis. Stat. § 71.25 *Sourcing*

(5)(a) (a) Apportionable income. Except as provided in sub. (6), corporations engaged in business both within and without this state are subject to apportionment. Income gain or loss from the sources listed in this paragraph is presumed apportionable as unitary or operational income or other income that has a taxable presence in this state. Apportionable income includes all income or loss of corporations, other than nonapportionable income as specified in par. (b), including, but not limited to, income, gain or loss from the following sources . . .

A partner's share of income or loss from a partnership or a member's share of income or loss from a limited liability company . . .

(9)(e) In this subsection, " sales" includes, but is not limited to, the following items related to the production of business income . . .

A partner's share of the partnership's gross receipts or a member's share of the limited liability company's gross receipts . . .

(15) (a) A general or limited partner's share of the numerator and denominator of a partnership's apportionment factors under this section are included in the numerator and denominator of the general or limited partner's apportionment factors under this section.

(b) If a limited liability company is treated as a partnership, for federal tax purposes, a member's share of the numerator and denominator of a limited liability company's apportionment factors under this section are included in the numerator and denominator of the member's apportionment factors under this section.

Wisconsin Tax Bulletin No. 197 (April 2017) *Sourcing*

### **Apportionment for Partnerships and Partners**

A partnership engaged in a unitary business both in and outside Wisconsin is a "multi-state partnership". A multi-state partnership will generally use Form A-1, Wisconsin Apportionment Data for Single Factor Formulas, or Form A-2, Wisconsin Apportionment Data for Multiple Factor Formulas, to determine the portion of income attributable to Wisconsin.

The information the partnership provides to a partner on Schedule 3K-1, Partner's Share of Income, Deductions, Credits, etc., to report their share of income depends on the type of partner:

A. Individual: A partner that is a nonresident individual reports his or her share of the partnership income after apportionment. The partnership reports this "Wis. source amount" in column (e) on Schedule 3K-1.

B. C-Corporation: A partner that is a C-Corporation reports its share of income, before apportionment, from the partnership. The partnership reports this amount in column (d), "Amount under Wis. law", of Schedule 3K-1. The partnership must also report the corporation's share of the partnership's apportionment factors in Part IV of Schedule 3K-1, Partner's Share of Apportionment Factors. The corporation combines the amounts from Part IV with its own apportionment factors on its Form A-1 or Form A-2.

C. Partnership or Tax-Option (S) Corporation: A partner that is a partnership or tax-option (S) corporation reports its share of income, before apportionment, from the partnership. The partnership reports this amount in column (d), "Amount under Wis. law", of Schedule 3K-1. The partnership must also report the partner's share of the partnership's apportionment factors in Part IV of Schedule 3K-1, Partner's Share of Apportionment Factors. The partnership or tax-option (S) corporation partner combines the amounts from Part IV with its own apportionment factors on its Form A-1 or Form A-2.

Wisconsin Instructions for Schedule A-01 (2023) *Sourcing*

Corporations, partnerships, tax-option (S) corporations and nonresident estates, trusts, and individuals that are engaged in a unitary business both in and outside Wisconsin generally use Schedule A-01 to compute the factors that will determine their Wisconsin share of income from a unitary business . . .

Partnerships, corporations, and tax-option (S) corporations must generally include their share of the numerator and denominator of a partnership's apportionment factors in the numerator and denominator of their apportionment factors. Include these

amounts using the Wisconsin apportionment Schedules A-01 through A-11, as appropriate . . .

**Sales to Pass-Through Entities Owned by Combined Group Members.** If a combined group member makes a sale to a pass-through entity which is more than 50 percent owned, directly or indirectly, by members of the combined group, the member must eliminate an amount equal to the gross receipts of the sale multiplied by the sum of all combined group members' interests in the pass-through entity as of the date of the sale. The examples below illustrate:

**Example 1:** Combined Group LM consists of Member L and Member M. L owns a 40% interest in Partnership P. M owns a 60% interest in Partnership P. On March 1, 2023, L sells a widget to Partnership P for \$10,000, and this sale is includable in Group LM's combined unitary income. In its computation of apportionment factors for 2023, L must subtract an amount of \$10,000 ( $= \$10,000 \times (40\% + 60\%)$ ) from its sales factor denominator and, if applicable, from its numerator.

**Example 2:** Assume the same facts as Example 1, except that Member L owns a 25% interest and M owns a 50% interest in Partnership P. In its computation of apportionment factors for 2023, L must subtract an amount of \$7,500 ( $= \$10,000 \times (25\% + 50\%)$ ) from its sales factor denominator and, if applicable, from its numerator.

**Sales by Pass-Through Entities Owned by Combined Group Members.** If a pass-through entity makes a sale to a combined group member and more than 50 percent of the pass-through entity is directly or indirectly owned by members of the combined group, each member with an interest in the pass-through entity must subtract from its sales factor numerator and denominator any amount that would otherwise be included attributable to the sale. The example below illustrates:

**Example:** Combined Group ST consists of Member S and Member T. S owns a 20% interest in Partnership R. T owns an 80% interest in Partnership R. On October 1, 2023, Partnership R sells a widget to S for \$20,000, and this sale is includable in Group ST's combined unitary income. In its computation of apportionment factors for 2023, S must subtract an amount of \$4,000 ( $= \$20,000 \times 20\%$ ) from its sales factor denominator and, if applicable, from its numerator. Similarly, T must subtract an amount of \$16,000 ( $= \$20,000 \times 80\%$ ) from its sales factor denominator and, if applicable, from its numerator.

#### Wisconsin Schedule 3K-1 Instructions (2023) *Sourcing*

A partnership that is engaged in a unitary business in Wisconsin and at least one other state or foreign country (known as "nexus") must determine the amount of income/loss attributable to Wisconsin for purposes of figuring the share of partnership income/loss taxable to partners that are nonresident or part-year resident individuals or fiduciaries. See sec. Tax 2.82, Wis. Adm. Code, to determine what constitutes nexus and sec. Tax 2.62, Wis. Adm. Code, for a description of what constitutes a unitary business.

All business income of a partnership is apportionable income, except as provided in the section below titled, *Income Not Subject to Apportionment Formula*. All apportionable business income is taxable to nonresident partners based on the apportionment formula regardless of whether the nonresident partner performs services in Wisconsin.

The Wisconsin source amount in column (e) is the amount from column (d) multiplied by the partnership's apportionment percentage from the Wisconsin apportionment Schedules A-01 through A-11. Include this schedule when filing Form 3, Wisconsin Partnership Return . . .

A partnership engaged in a nonunitary business (one in which the operations in Wisconsin are not dependent upon or contributory to the operations outside Wisconsin)

in and outside Wisconsin must determine the amount of income attributable to Wisconsin by separate accounting. Under separate accounting, the partnership must keep separate records of the sales, cost of sales, and expenses for the Wisconsin business. Use Form C, Wisconsin Allocation and Separate Accounting Data, to compute the income allocable in and outside Wisconsin. Include the schedule when filing Form 3, Wisconsin Partnership Return.

Except for nonunitary income, and except for income/loss items not requiring apportionment as explained above, a unitary business may use separate accounting only with the approval of the department . . .

Partnerships, corporations, and tax-option (S) corporations must generally include their share of the numerator and denominator of the partnership's apportionment factors in the numerator and denominator of their apportionment factors, even if the election to pay tax at the entity level was made. Include these amounts using the Wisconsin apportionment Schedules A-01 through A-11, as appropriate. For a corporation or another partnership that is a partner, enter on line 25 or lines 26 through 28 the partner's proportionate share of the partnership's apportionment factors from the Wisconsin apportionment Schedule A-01 through A-11 (if applicable).

Wis. Stat. § 71.255 *Sourcing*

(1)(n) Any business conducted by a pass-through entity that is owned directly or indirectly by a corporation shall be treated as conducted by the corporation, to the extent of the corporation's distributive share of the pass-through entity's income, regardless of the percentage of the corporation's ownership interest. A business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a pass-through entity if there is a synergy and exchange and flow of value between the 2 parts of the business and the 2 corporations are members of the same commonly controlled group . . .

(5)(a)(6) The numerator and denominator, described in subs. 1. to 5., shall include the sales, receipts, or premiums of pass-through entities that are owned directly or indirectly by a corporation in proportion to a ratio the numerator of which is the amount of the corporation's distributive share of the pass-through entity's unitary business income included in the income of the combined group under sub. (4) and the denominator of which is the amount of the pass-through entity's total unitary business income.

Wis. Admin. Code Tax 2.62 *Sourcing*

(7)(a) A passive holding company that is in a commonly controlled economic enterprise and holds intangible assets that are used by the enterprise in a unitary business shall be deemed to be engaged in the unitary business, even if the holding company's activities are primarily passive.

(7)(b) A passive parent holding company that directly or indirectly controls one or more operating company subsidiaries engaged in a unitary business shall be deemed to be engaged in a unitary business with the subsidiary or subsidiaries, even if the holding company's activities are primarily passive.

(8)(a) For purposes of determining the scope of the unitary business, any business conducted by a pass-through entity that is controlled directly or indirectly by a corporation shall be treated as conducted by the corporation to the extent of the corporation's distributive share of the pass-through entity's income, regardless of the percentage of the corporation's ownership interest.

(8)(b) Any business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or

indirect interest in a pass-through entity if the requirements of s. 71.255(1) (n), Stats., are otherwise met with respect to the corporations' interests in the pass-through entity and the corporations are members of the same commonly controlled group.

*GP Tangible Investments, LLC v. Wisconsin Department of Revenue*, Dkt. No. 12-R-151 (Wis. Tax. App. (February 13, 2014). *Sourcing*

The parties agree that GPTI is treated as a partnership under the relevant statutes. GPTI in turn is a partner of GP Operations, a partnership which generated income in several states, including Wisconsin. GP Operations attributed a portion of its income to Wisconsin. GPTI received its share of that Wisconsin income when it was passed through from GP Operations. Petitioner reported the income it received from GP Operations on its federal and state partnership returns. One detail remains problematic. Is receiving pass-through income which is generated in Wisconsin the same thing as “deriving income” from business transacted in Wisconsin . . .

For each year at issue, GPTI reported gross receipts on its federal form 1065 and on its Form 3 Wisconsin Partnership Returns. Those gross receipts included and in fact consisted solely of income passed through from the first-tier partnership GP Operations. Pass-through income from a partnership is included in “receipts . . . from business activities,” per the Administrative Code's definition of “gross receipts.” Thus, Petitioner has income from business activities in Wisconsin . . .

By virtue of the pass-through income received from GP Operations, GPTI is a partnership which derives income from business activity in Wisconsin.

Wisconsin Tax Bulletin No. 208 (2020) *Sourcing, PTE*

A partnership that makes the election to pay tax at the entity level for Wisconsin under sec. 71.21(6)(a), Wis. Stats., must determine income, loss and deductions attributable to Wisconsin pursuant to sec. 71.04, 71.14, 71.25, 71.362, or 71.45, Wis. Stats., as if the election was not made.

If the electing partnership is part of a multi-tiered entity structure (i.e., another partnership owns a percentage of the capital and profits of the electing partnership), the electing partnership must look through all the tiers of the multi-tiered entity to determine income, loss and deductions attributable to Wisconsin. For additional detail, see example 2 under Column (c) of the Schedule 3-ET Instructions.

Wisconsin Department of Revenue Website - Pass-Through Entity-Level Tax: Partnership Determining Income and Computing Tax *PTE*

#### Example 2 - Determining Wisconsin Sourced Income in a Multi-Tiered Structure

Note: For multi-tiered entity tax calculations, the electing partnership must include a supplemental schedule with Form 3, Wisconsin Partnership Return, showing how the tax is being computed.

Wis. Stat. § 71.775(2)(b) *Withholding/Return*

A pass-through entity that is also a member of another pass-through entity is subject to withholding under this subsection and shall pay the tax based on the share of income that is distributable to each of the entity's nonresident partners, members, shareholders, or beneficiaries.

Wis. Stat. § 71.775(3) *Withholding/Return*

Exemptions . . .

- (a) A nonresident partner's, member's, shareholder's, or beneficiary's share of income from the pass-through entity that is attributable to this state shall not be included in determining the withholding under sub. (2) if any of the following applies . . .

the pass-through entity has elected under s. 71.21 (6) (a) or 71.365 (4m) (a) to be taxed at the entity level.

#### Wisconsin Pass-Through Entity Withholding Common Questions *Withholding/Return*

##### **What happens when a pass-through entity is in a "tiered" structure, where it owns another pass-through entity?**

If a pass-through entity (called an "upper-tier entity") owns another pass-through entity (called a "lower-tier" entity), the lower-tier entity is required to withhold on the Wisconsin income allocable to the upper-tier entity. The upper-tier entity may then take credit for tax already withheld by the lower-tier entity when it withholds on behalf of its own nonresident members.

Alternatively, the upper-tier entity may file an exemption affidavit (Form PW-2) to elect out of withholding from the lower-tier entity. In this case, the upper-tier entity would pay the withholding on its total Wisconsin income allocable to its nonresident members even if that income is from the lower-tier entity.

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