

May 29, 2026

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Re: Multistate Tax Commission Draft Model Provisions and Related White Paper on State Tax Sourcing of Partnership Income

Dear Helen:

We appreciate the opportunity to submit the following comments on the Multistate Tax Commission's ("MTC") combined draft model provisions and recommendations (dated April 15, 2026) ("Draft Provisions") and the related white paper on sourcing partnership income (dated January 29, 2026) ("White Paper"), with particular focus on the proposed "absolute value method" for determining a partner's share of partnership apportionment factors in the context of blended apportionment.

We commend the MTC and the Work Group on State Taxation of Partnerships ("Work Group") for their continued efforts to develop uniform guidance in an area of taxation that is undeniably complex. However, as detailed below, we have significant concerns that the proposed absolute value method introduces a novel computational approach that may produce distortive results, create financial reporting vulnerability, and impose substantial administrative burdens.

I. Background

A "partnership" for purposes of the MTC project means any entity taxed under IRC Subchapter K, including general partnerships, limited partnerships, limited liability partnerships, and LLCs. A broad range of commercial, financial, professional, and investment businesses operate in partnership form. Partnerships often consist of a mix of investors—individuals, corporations, tax-exempt organizations, and trusts. Tiered partnership structures are also common and often serve various governance and financing requirements.

As the MTC has recognized, the federal partnership tax system has "a well-earned reputation as one of the most complex areas of the tax law."¹ For such a complex area, the MTC rightly bases the Draft Provisions on federal conformity, *i.e.*, states are conforming to the principle that partnership tax items are attributed to the partners as if the partners had engaged in the partnership's activities directly.

The White Paper recognizes four different methods for determining a partner's share of a partnership's apportionment factors: (1) the item-based approach, (2) the interest-based approach, (3) the capital share-based approach, and (4) the distributive share-based approach. The White Paper identifies specific problems with each and concludes the distributive share approach is best, paired with converting items to absolute values to solve the potential negative distributive share issue caused by special allocations.

¹ Multistate Tax Commission, *State Taxation of Partnerships Issue Outline* (Jan. 1, 2025), <https://www.mtc.gov/wp-content/uploads/2024/12/Partnership-Outline-January-1-2025.pdf>.

II. Allocations of Partnership Tax Items

Special allocations are in no way “special” or unique. Indeed, they may be required as part of the partnership agreement when different partners bear the economic benefits or burdens of a partnership tax item. Particular allocations may only affect some partners, but not all.

In general, a partner’s distributive share is determined based on the partnership agreement.² If the partnership agreement provides for an allocation of a partnership item of income, gain, deduction, loss, or credit, the allocation is only respected if it satisfies the substantial economic effect (“SEE”) requirement.³ The Section 704(b) regulations are designed to allocate tax items to the partner(s) who benefit (or are burdened) economically by a partnership tax item.

The “substantiality” aspect of SEE generally means that if the result of an allocation is to enhance the after-tax economic consequences of one partner, then the after-tax economic consequences of another partner must be diminished.⁴ A partnership simply cannot arbitrarily allocate partnership tax items among the partners. Tax has to follow economics. Among other provisions, two special rules invalidate specific types of allocations under the “substantiality” requirement—shifting allocations and transitory allocations. A shifting allocation is an intra-year allocation intended to shift tax consequences but not affect significant economic consequences. A transitory allocation is an allocation that will be offset at some later date.

III. The MTC’s Proposed Absolute Value Method

The Draft Provisions acknowledge that the distributive share approach is conceptually preferable but raises an issue when the partnership makes special allocations, as such special allocations may result in a partner having a negative share of distributive income whereas the partnership’s total income is positive, or vice versa. To address this issue, the Work Group has proposed the use of the absolute value method.

Under the absolute value method, an upper-tier partnership or corporate partner determines its share of a partnership’s apportionment factors using its distributive share of partnership income calculated using the absolute value of the items making up that distributive share. The absolute value method only applies when special allocations are made. However, this limitation currently only appears in a note to the Draft Provisions, rather than in the Draft Provisions’ statutory language.

While the absolute value method is not itself a partnership allocation, it could be viewed as a shifting allocation outside of the partnership. It is an intra-year allocation of apportionment factors that only affects the tax consequences to one or more partners without any corresponding economic consequences.

A. The Absolute Value Method Creates a Novel Approach that Will Cause Confusion

The proposed absolute value method creates a “new” method that deviates from methods already in use, which is guaranteed to create confusion in an already complicated area. No state currently

² Treas. Reg. § 1.704-1(a).

³ Treas. Reg. § 1.704-1(b)(1)(i). *See also* Treas. Reg. § 1.704-1(b)(3). If the allocation fails SEE, then a partner’s distributive share of the item is determined in accord with the partner’s interest in the partnership, a facts and circumstances test. *Id.*

⁴ Treas. Reg. § 1.704-1(b)(2)(iii)(a). *See also* Treas. Reg. § 1.704-1(b)(5), Example (5) and Example (9). The “economic effect” of SEE is usually satisfied based on three objective safe harbors: (1) the partnership maintains partner capital accounts in accord with the Section 704 regulations; (2) partnership liquidating distributions are made in accordance with positive partner capital accounts; and (3) partners have a capital account deficit restoration obligation. Treas. Reg. § 1.704-1(b)(2)(ii)(b).

employs an absolute value method for determining a partner's share of partnership apportionment factors. Practitioners, taxpayers, and state tax agencies have developed familiarity with existing blended apportionment approaches—introducing a new method invites significant interpretive disputes and inconsistent application across jurisdictions.

B. The Absolute Value Method Can Result in Distortion

While the absolute value method aims to resolve disparities, it may introduce potential distortions by flowing up partnership apportionment factors based on the gross magnitude of a partner's specially allocated items rather than the partner's actual net income relationship to the partnership. Thus, the proposed absolute value method may assign a partner a substantial share of partnership receipts even where the partner's net distributive share is minimal or negative. This could result in outcomes that do not reflect economic reality, especially when blended into a corporate partner's apportionment formula.

Illustrative Example

Assume two corporate partners (Partner A and Partner B) each have a 50% interest in Partnership 1. Partnership 1 engages in two types of activities, but all items of its income are apportionable and derived from a unitary business.

Partnership Structure and Income

- Activity 1: Partnership 1 earns \$300,000 of gross receipts and incurs (\$1,100,000) in expenses, resulting in a net loss of (\$800,000). The \$300,000 of receipts are specially allocated to Partner B, while the (\$1,100,000) deduction is specially allocated to Partner A.
- Activity 2: Partnership 1 earns \$2,500,000 of gross receipts and incurs (\$100,000) of deductions, resulting in net income of \$2,400,000. This income is split 50/50 to each partner.
- Total: Partnership 1's total net income is \$1,600,000. Of that, Partner A receives \$100,000 and Partner B receives \$1,500,000. Partner A's distributive share of Partnership 1's income is 6.25%,⁵ and Partner B's distributive share is 93.75%.⁶

				Partners	
		Pship		Partner A	Partner B
Activity 1	Gross receipts	\$300,000	Special allocation	\$0	\$300,000
	Deductions	(\$1,100,000)	Special allocation	(\$1,100,000)	\$0
	Net income	(\$800,000)			
Activity 2	Gross receipts	\$2,500,000			
	Deductions	(\$100,000)			
	Net income	\$2,400,000	P&L (50%/ 50%)	\$1,200,000	\$1,200,000
Total net income		\$1,600,000		\$100,000	\$1,500,000

Apportionment Factor: Standard Distributive Share Method vs. Absolute Value Method

Partnership 1's total receipts equal \$2,800,000. None of Partnership 1's receipts are attributable to State X.

⁵ 6.25% = \$100,000 / \$1,600,000

⁶ 93.75% = \$1,500,000 / \$1,600,000

- Under the standard distributive share method (*i.e.*, without using absolute values) (“DS Method”), 6.25% of Partnership 1’s total receipts (*i.e.*, \$175,000) are flowed up to Partner A for purposes of computing Partner A’s apportionment factor.
- Under the absolute value method (“ABS Method”), however, 60.53% of Partnership 1’s total receipts (*i.e.*, \$1,694,737) are flowed up to Partner A for the same purpose.

	Partner A	Partner B
ABS Activity 1	\$1,100,000	\$300,000
ABS Activity 2	\$1,200,000	\$1,200,000
Total ABS	\$2,300,000	\$1,500,000
Ratio of receipts	60.53%	39.47%
Share of Pship receipts	\$1,694,737	\$1,105,263

Impact on Partner A’s State Tax Apportionment

In addition to the \$100,000 of income from Partnership 1, Partner A has \$900,000 of other business income. Partner A generates receipts of \$1,000,000, all of which are attributable to State X. In calculating Partner A’s blended sales factor, the only variable in flowing up its share of Partnership 1’s receipts is the amount of everywhere receipts included in the denominator, as Partnership 1 has \$0 receipts attributable to State X.

- Under the DS method, Partner A’s total everywhere receipts are \$1,175,000. With \$1,000,000 of State X receipts in the numerator, Partner A has a State X apportionment percentage of 85.11% and \$851,064 of income apportioned to State X.
- Under the ABS method, however, Partner A’s total everywhere receipts balloon to \$2,694,737. With the same \$1,000,000 of State X receipts, the State X apportionment percentage plummets to 37.11%, and income apportioned to State X drops to \$371,094.

	Partner A	
	DS Method	ABS Method
State X - Partner A	\$1,000,000	\$1,000,000
State X - Pship 1	\$0	\$0
State X - Total	\$1,000,000	\$1,000,000
Everywhere - Partner A	\$1,000,000	\$1,000,000
Everywhere - Pship 1	\$175,000	\$1,694,737
Everywhere - Total	\$1,175,000	\$2,694,737
State X Apportionment %	85.11%	37.11%
	DS Method	ABS Method
Pship 1	\$100,000	\$100,000
Partner A OBI	\$900,000	\$900,000
Total income	\$1,000,000	\$1,000,000
State X Appt. %	85.11%	37.11%
State X Income	\$851,064	\$371,094

Why the Absolute Value Method is Distortive

The core of the distortion lies in how the absolute value method treats a specially allocated deduction—a negative economic item—as though it were a positive input for purposes of weighting Partner A’s share of Partnership 1’s receipts. This causes Partner A, whose actual net distributive share of Partnership 1’s income is 6.25%, to appear as though it should bear 60.53% of

Partnership 1's total receipts. This example illustrates a fundamental flaw: the ABS method drives factor shares by the gross magnitude of allocated items rather than the partner's true economic interest in the partnership.

C. Administrative Burden

The ABS method may not be administratively feasible for tax return compliance, particularly for complex or tiered partnerships with special allocations.

- Timing for compliance. The partner's actual distributive share percentages and special allocations for purposes of flowing up apportionment factors may not be known until the partnership completes its federal return and K-1 reporting. As a result, the partner cannot reliably compute its own state apportionment factor on a timely basis. This creates dependency problems for partners and makes timely filing exceedingly difficult.
- Information needed from partnerships. Each partner will need visibility into all of the partners' K-1 items and distributive share of the partnership's items to verify the absolute value calculation. In practice, this means that the partnership must transmit sufficient detail about the partnership's total items (including items allocated to other partners) to enable each partner to independently verify the absolute value calculation. This level of data exchange is unprecedented and raises serious practical concerns.

D. ETR and Financial Reporting Vulnerability

The ABS method can create tax provision and effective tax rate ("ETR") vulnerability, as state ETRs may become volatile, difficult to forecast, dependent on late-arriving partnership data, and hard to explain as a function of actual operating changes rather than partnership allocation mechanics.

Under the ABS method, changes in a partnership's special allocations alone (with no changes in the partnership's underlying activities or the partner's economic stake) can cause dramatic year-over-year swings in a partner's state apportionment percentage. Thus, the absolute value method could swing state ETRs significantly because a partnership's special allocation profile changed in a way that meaningfully impacts the partner's state apportionment factor calculation. This volatility is problematic as it reduces confidence in forecasted ETRs, which directly impacts confidence of investors.

For example, using the illustrative example above, if in Year 2 the Activity 1 deduction was reduced from (\$1,100,000) to (\$100,000) while all other items remained the same, Partner A's share of Partnership 1's receipts under the ABS method would change materially even though the partnership's actual business operations in the state remained unchanged.

IV. Alternatives to the Absolute Value Method

A. Rely on Established Methods Rather than Creating a New One

The ABS method was developed to address a narrow concern: that the standard distributive share method can produce negative distributive share percentages when a partnership makes special allocations. However, this concern does not justify the creation of an entirely new computational methodology.

To the extent the standard DS method results in a partner having a negative distributive share percentage, we recommend that the Work Group focus on one of the methods already in use, rather than creating a new one. Established approaches—including the standard distributive share method and capital share method—have the advantage of practitioner familiarity and existing precedent.

Where a partnership agreement includes special allocations whose principal purpose is the avoidance or evasion of state tax, the appropriate remedy is to disregard those allocations under applicable anti-abuse rules, not to impose a blanket computational method that applies regardless of whether an allocation is economically legitimate or abusive. The ABS method attempts to solve a problem that either does not exist or is better addressed through targeted enforcement mechanisms.

B. Encourage States to Adopt Anti-Abuse Rules Related to Partnership Allocations Used to Shift Income for the Purpose of Evading State Tax

In addition to the above, we recommend that the MTC model provisions focus on a targeted anti-abuse rule that would authorize states to disregard a partnership allocation if it shifts income for the *principal* purpose of avoiding or evading state tax. The White Paper already recognizes that states may need specialized anti-abuse rules to prevent income shifting that standard rules do not adequately address. These rules can be effectively administered without the need for a novel approach like the ABS method.

Some states have already implemented such rules. Connecticut and New York, for example, provide that even where a special allocation is not principally aimed at avoiding federal tax, the allocation shall be disregarded if its principal purpose is the avoidance or evasion of Connecticut income tax or New York franchise tax. Other states take a similar approach. These states' approach looks to surrounding facts and circumstances, including the business purpose of the allocation, whether the allocation has substantial economic effect independent of state income tax consequences, the timing and duration of the allocation, and the overall state income tax consequences.

We appreciate the Work Group's efforts to understand state partnership tax rules. We ask that the Work Group take the above into consideration for purpose of issuing its model provisions with respect to determining a partner's share of partnership apportionment factors in the context of blended apportionment.

Respectfully,



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