



State Taxation of Partnerships – Comments on Draft Model Provisions

JUNE 17, 2026

COMMENTS ON THE DRAFT MODEL PROVISIONS

- From –
 - AICPA
 - Eversheds-Sutherland
 - Energy Infrastructure Council
- Also expecting comments from the ABA
- Will be issuing a revised draft model with certain edits
- For other comments we have an initial response (based on past discussions) but may need further discussion



BEFORE WE GET STARTED . . .

SOME ESSENTIALS ARE WORTH NOTING



STATE INCOME TAX ESSENTIALS

PARTNERSHIPS GENERALLY

Creatures of state law.

Also governed by their agreements.

Any legal relief to partners is express.

PARTNERSHIPS GENERALLY

Partnerships often accommodate the specific legal obligations of their partners by providing for this in their agreements.

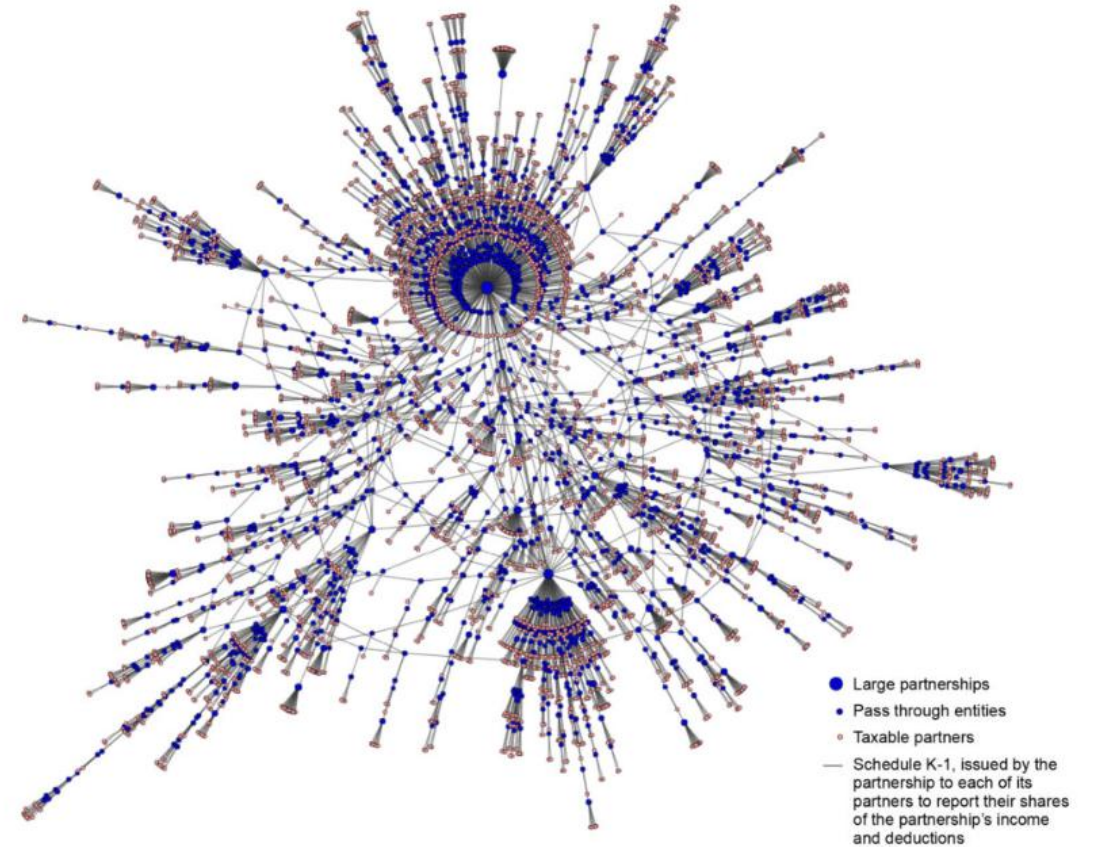
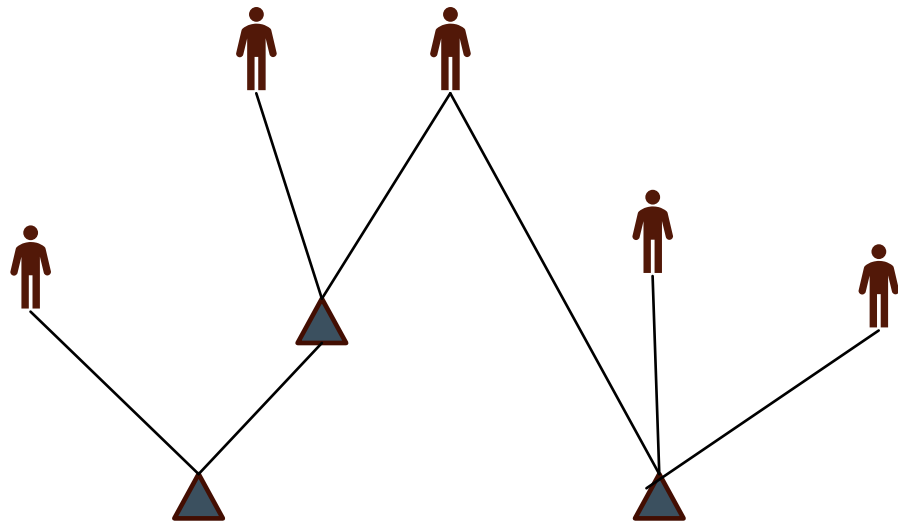
**PARTNERSHIP
STRUCTURES**

Most are small and simple.

Some are large, complex, tiered structures.

Large partnerships generate most income.

PARTNERSHIPS STRUCTURES



Source: Internal Revenue Service. | GAO-23-106020

Source: U.S. Government Accountability Office, “Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships” (2023), Figure 7, available at <https://www.gao.gov/assets/gao-23-106020.pdf>.

STATE INCOME TAX ESSENTIALS

ANNUAL REPORTING OF NET INCOME

No perfect matching. Expenses create future income.

Sourcing can also vary from year to year.

Income allocations can also change capital accounts.

ANNUAL REPORTING OF NET INCOME

You would get a different result if you could look back over a longer period to compute and apportion income.

STATE INCOME TAX ESSENTIALS

APPORTIONMENT OF NET INCOME

Formula applies equally to all items.

Today 80% of states use a receipts factor.

Equitable apportionment may apply.

APPORTIONMENT TO SOURCE INCOME

States are NOT REQUIRED to use apportionment and often source items using different methods.

STATE INCOME TAX ESSENTIALS

PASS-THROUGH SYSTEM CONFORMITY

Provides substantial benefits to businesses.

Partnership determines tax character of items.

Partnerships must provide partners information.

PASS-THROUGH SYSTEM CONFORMITY

Partners may also need partnerships to provide additional information so they can comply with state tax law.

STATE INCOME TAX ESSENTIALS

ATTRIBUTION OF SOURCING INFO

Tax effects are determined by partnership activities and attributed to partners.

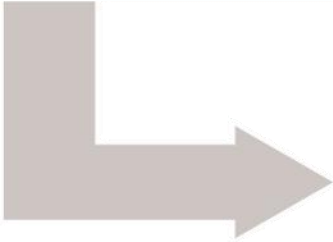
Partnership activities also affect the income's source.

Partner activities /attributes may affect sourcing.

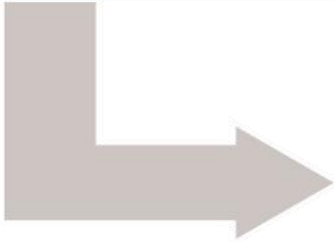
ATTRIBUTION OF SOURCING INFO

Default – income is sourced based on character determined by partnership activities. Blending may apply to some partners.

Partnership determines items' tax and sourcing character



Partnership reports necessary information to partners.



Partners use the source determined by partnership for their share except . . .

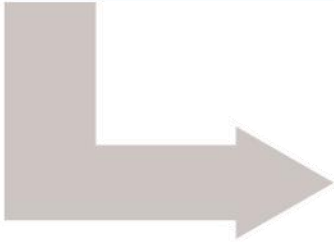


Certain partners may use blended apportionment . . .

Partnership determines items' tax and sourcing character



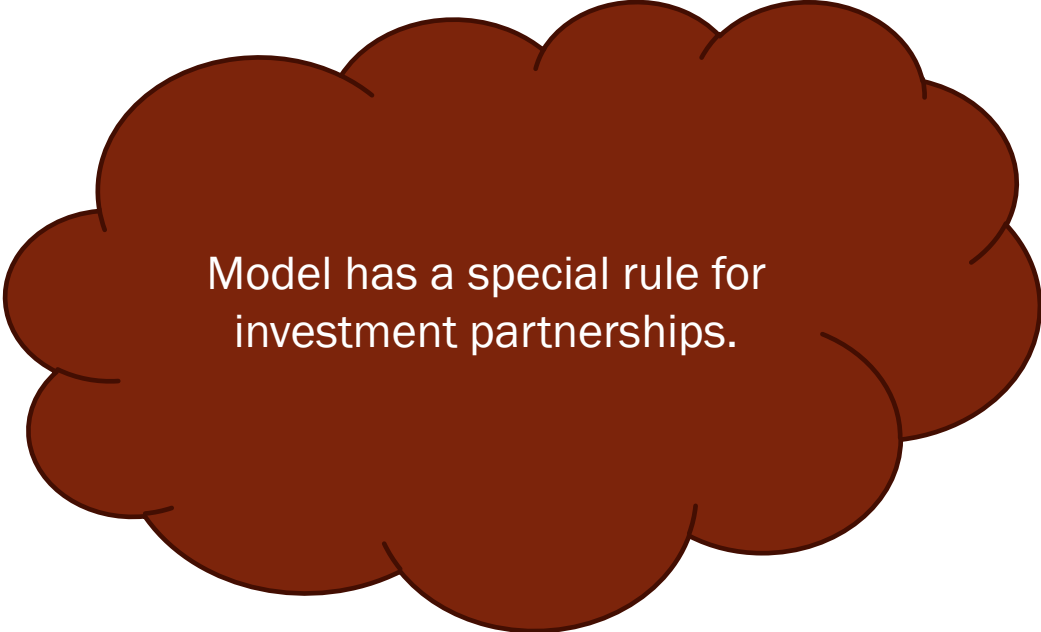
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Information Reporting

Are the draft requirements reasonable?

When to Blend

Is the UBP the right standard and how does it apply?

How to Blend

How is the partner's share of factors determined?

GENERAL COMMENTS



Information Reporting

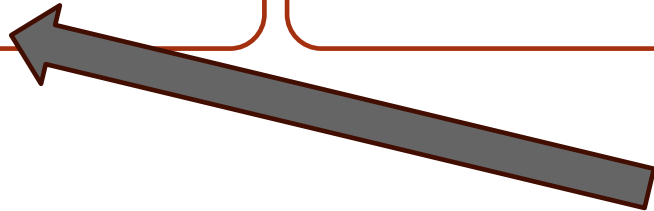
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GENERAL COMMENTS



INFORMATION REPORTING

ARE THE DRAFT REQUIREMENTS REASONABLE?

INITIAL RESPONSE – SUBJECT TO FURTHER DISCUSSION



INFORMATION REPORTING REQUIREMENTS – GENERAL STATE LAW

Uniform Law Commission's Model Acts – Versions Most Widely Adopted

Uniform Partnership Act-1997 (updated as of 2013)

SECTION 408. Rights to Information of Partners and Persons Dissociated as Partner.

available here: <https://www.uniformlaws.org/viewdocument/final-act-98?CommunityKey=52456941-7883-47a5-91b6-d2f086d0bb44&tab=librarydocuments>

Uniform Limited Liability Company Act (as updated 2013)

SECTION 410. Rights to Information of Member, Manager, and Person Dissociated as Member

Available here: <https://www.uniformlaws.org/viewdocument/final-act-83?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740&tab=librarydocuments>

INFORMATION REPORTING REQUIREMENTS – GENERAL STATE LAW

Rules provide that:

- Partners may “inspect and copy” partnership records
- Certain information will be furnished without demand
- Certain information will be furnished upon demand
- This applies to past partners as well

INFORMATION REPORTING REQUIREMENTS – GENERAL STATE LAW

From the Comments Section in the UPA:

Although the rights and duties stated in this section [to which information pertains] are extensive, they are not necessarily all-inclusive.

...Subsection (a)—A general partnership is often a very informal organization. Accordingly, this subsection states a default-required location for any books and records a partnership may have but does not require that books and records be kept. Other law may so require, however—particularly tax law. This subsection applies to any books and records kept to satisfy other law.

**MINIMUM
INFORMATION
PARTNERSHIPS
AND PARTNERS
MUST HAVE:**

- **Partnerships**
 - **With respect to their partners –**
 - Direct partner identity and location
 - Partner capital accounts
 - Agreed upon shares of income and items
- **Partners (including tiered partners)**
 - **With respect to their direct partnerships –**
 - Business and transactional information
 - Assets held by partnership (including partnership interests)

IRC § 6031 - Return of partnership income

(a) General rule

Every partnership . . . shall make a return . . . stating specifically the items of its gross income and the deductions allowable by subtitle A, and such other information . . . and shall include in the return the names and addresses of the individuals who would be entitled to share in the taxable income . . . and the amount of the distributive share of each individual.

(b) Copies to partners

Each partnership . . . shall . . . furnish to each person who is a partner . . . a copy of such information required to be shown on such return as may be required by regulations. . . .

. . .

FEDERAL PARTNERSHIP REPORTING REQUIREMENTS

26 CFR § 1.6031(a)-1 - Return of partnership income.

(a) Domestic partnerships—(1) Return required. . . . every domestic partnership must file a return of partnership income under section 6031 (partnership return) for each taxable year **on the form prescribed . . .**

(2) Content of return. The partnership return **must contain the information required by the prescribed form and the accompanying instructions.**

(3) Special rule.

(i) A partnership that has no income, deductions, or credits for federal income tax purposes for a taxable year is not required to file a partnership return for that year.

(ii) **The Commissioner may, in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), provide for an exception to partnership reporting under section 6031 . . .**

[More lengthy provisions related to foreign partnerships and partners.]

FEDERAL PARTNERSHIP REPORTING REQUIREMENTS

■ Federal Requirements

- Are becoming more detailed. (See the Partnership Return – IRS 1065 and all related schedules, including Schedule K, as well as information returns for partners – Schedule K-1.)
- Apply to tiered-partnership structures so that lower-tiered partnerships must report information to upper-tier partnerships and indirect taxpaying partners.
- 26 U.S. Code § 6222 - Partner's return must be consistent with partnership return - otherwise an adjustment is treated as a mathematical or clerical error.

FEDERAL PARTNERSHIP REPORTING REQUIREMENTS

PROPOSED DRAFT MODEL PROVISIONS – PART III

A. A partnership shall provide to its direct partners the information necessary for its direct and indirect partners to properly compute and report their [STATE] tax. Necessary information includes any information as described or provided for in regulations, forms, and instructions issued by the [STATE TAX AGENCY]. This requirement to provide information applies to:

1. Any partnership doing business in [STATE];
2. Any partnership that has a direct or indirect partner doing business in or resident in [STATE].
3. Any partnership that has a direct or indirect interest in a partnership doing business in [STATE].

PROPOSED DRAFT MODEL PROVISIONS – PART III

B. A partnership shall provide to the [STATE TAX AGENCY] certain information as directed by the [STATE TAX AGENCY] necessary to verify the information required to be reported to partners under Subpart A, above and as provided in regulations, forms, and instructions issued by the [STATE TAX AGENCY].

PROPOSED DRAFT MODEL PROVISIONS – PART III

C. The type of information that may be required to be reported to partners or to [STATE TAX AGENCY] under this Part III includes:

1. **Federal tax-related information**, including the tax character of partnership income and items recognized by the partnership or allocated to the partnership from lower-tier partnerships;
2. **State tax-related information**, including the tax character of partnership income and items recognized by the partnership or allocated to the partnership from lower-tier partnerships, as relevant to compliance with [REFERENCE TO STATE INCOME TAX RULES FOR CORPORATIONS AND INDIVIDUALS];

PROPOSED DRAFT MODEL PROVISIONS – PART III

C. (Cont'd):

...

3. Information necessary for direct or indirect partners to properly determine the source of partnership income and items, as described further in this Section;

4. Information from lower-tier partnerships or business entities in which the partnership holds an interest that is necessary for that partnership's direct or indirect partners to properly determine the source of partnership income and items as described further in this Section; and

5. Any other information the partnership may have or obtain that is necessary for direct or indirect partners to properly report their state tax on partnership income and items.

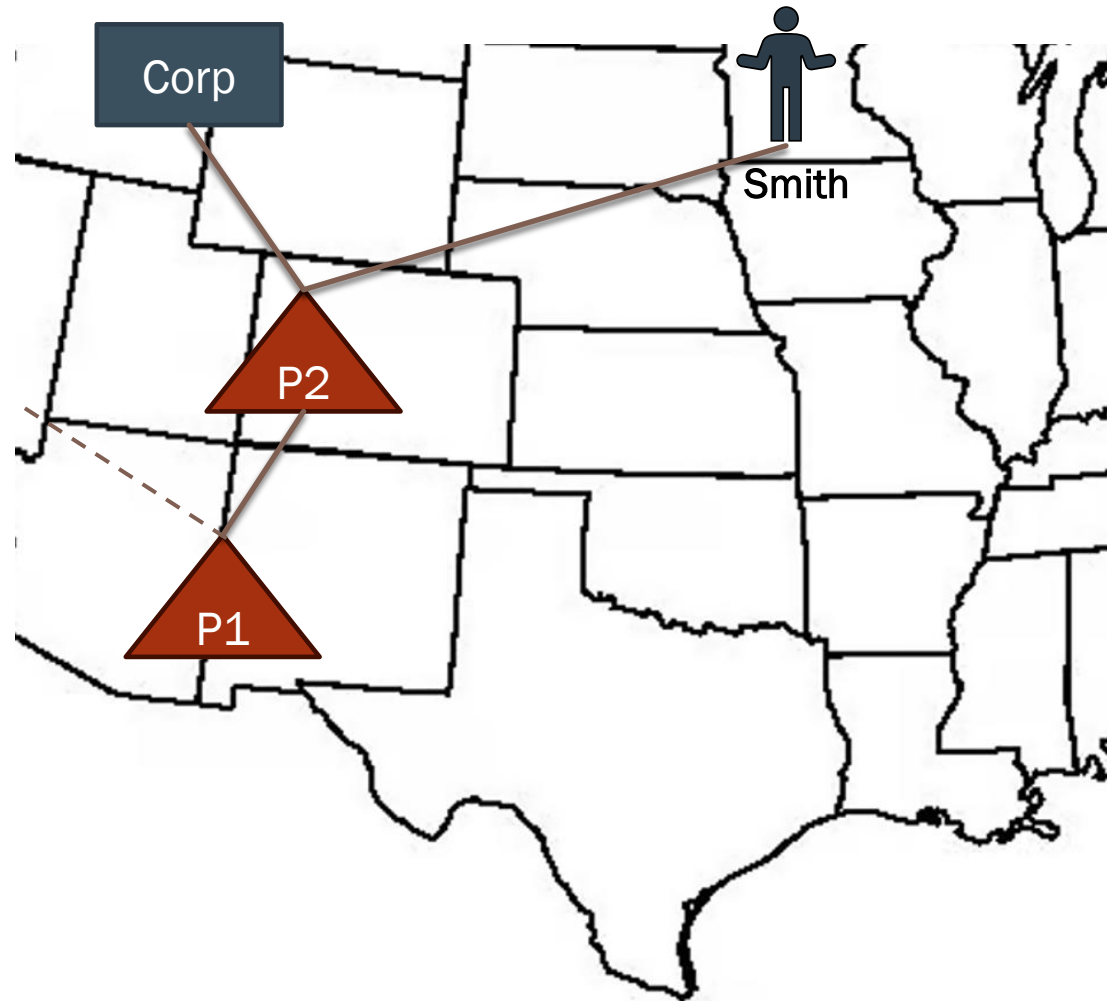
KINDS OF INFORMATION REPORTING

- **Partnerships to partners –**
 - Official forms required for filing tax returns.
 - Other information as requested by the partners.
- **Partnerships to state –**
 - Official forms required for filing tax returns (or copies of those forms provided to partners)
 - Other information as requested by the state or required to be kept in case requested.

GENERAL TAX INFORMATION REPORTING

What would partners Corp and Smith expect to know about their portion of P2 income and items that comes from P1:

- ✓ It comes from P1
- ✓ The share they agreed to allocate
- ✓ Federal tax character of items making up the share
- ✓ Whether state withholding or entity-level taxes applied (and how P1 sourced the income for that purpose)

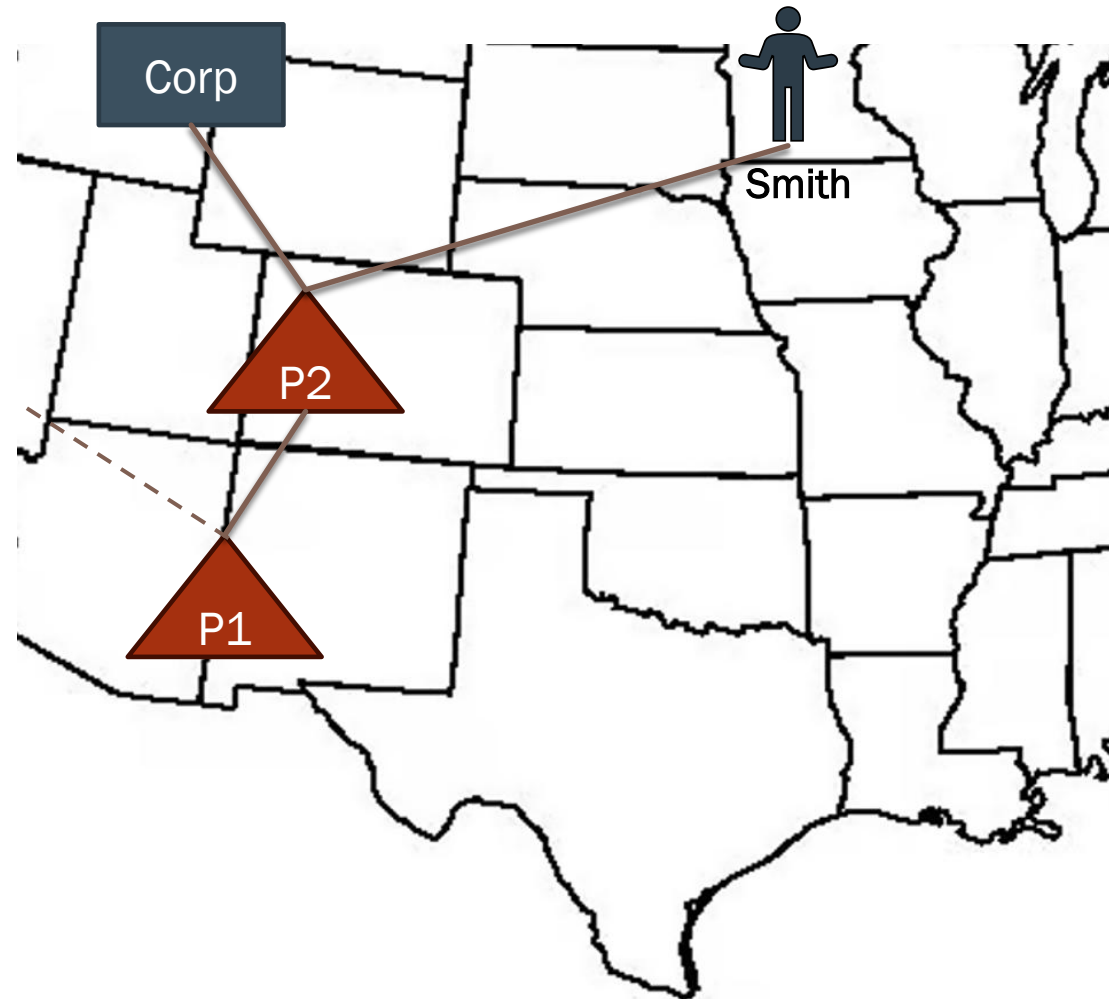


STATE SOURCING INFORMATION REPORTING – NO BLENDING

P1 determines whether income and items are:

- Apportionable
- If so – related factors for each state
- If not – source based on state rules

P1 provides this information to P2 which then provides the information to Corp and Smith so they can source their share of the P1 income and items.

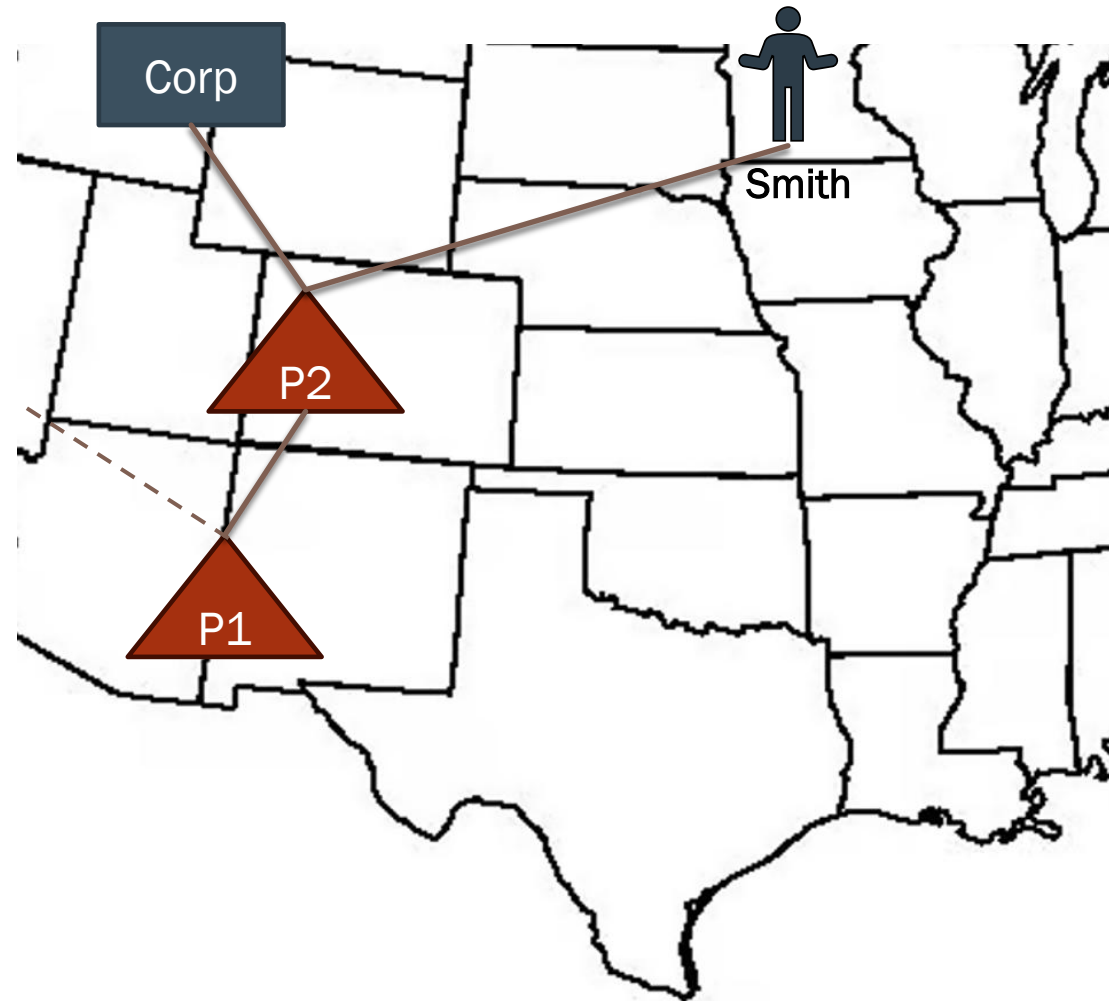


STATE SOURCING INFORMATION – BLENDING

Assume Corp determines it should use blending to source the distributive share from P1 that passes through P2.

Corp will need to have information on:

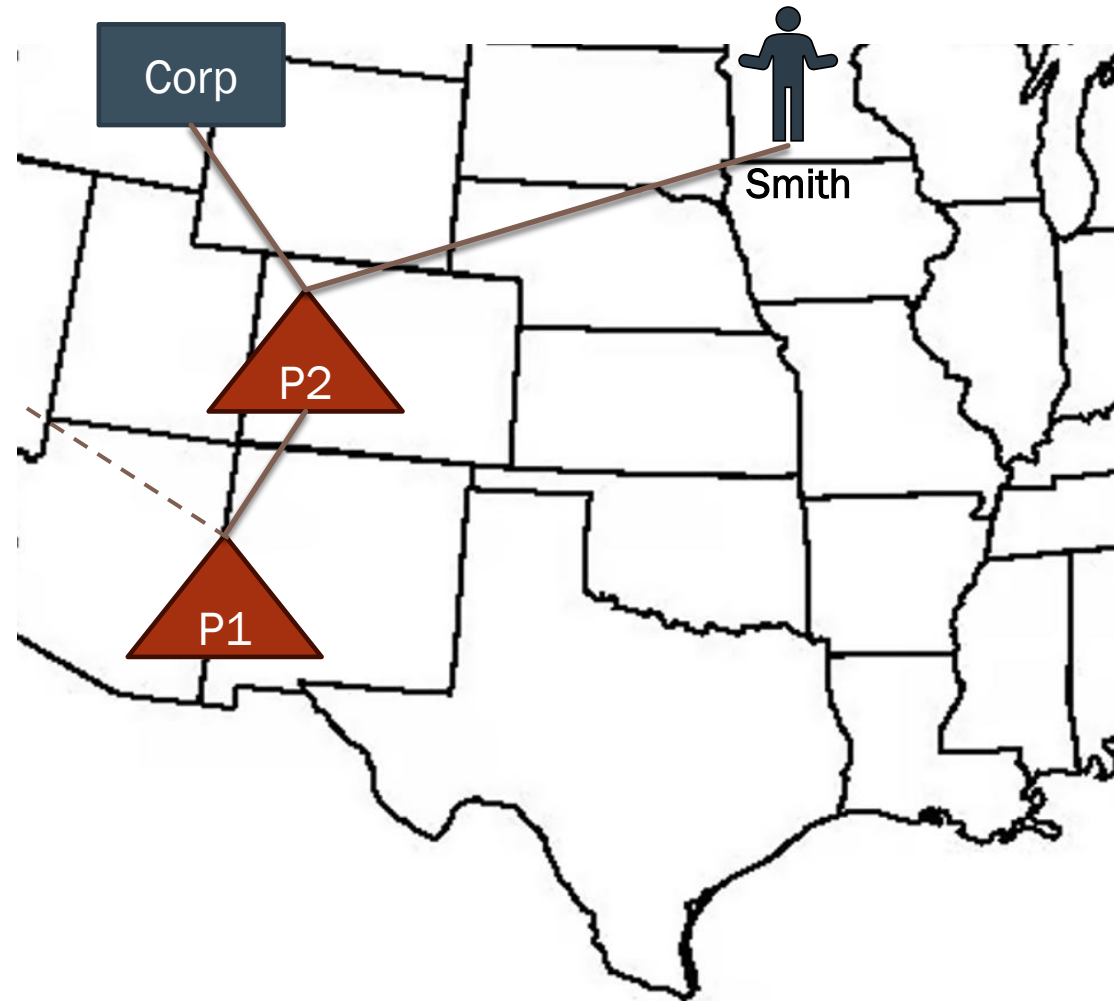
- P1 factors in each state
- Information on distributive share



STATE ADJUSTMENT INFORMATION

Assume Smith is in a state that has de-conformed to federal depreciation rules and P1's distributive share allocated to P2 (and from P2 to Smith) includes depreciation expense.

P1 needs to know that it may need to provide information to Smith so that Smith can recompute the effect of the decoupling (depending on how the state applies the rule).



INFORMATION REPORTING IS CRITICAL – BUT RULES COME FIRST



- Adjustment information

- Rules are fairly clear

- Reporting requirements and process may not be sufficient

- One option – states could provide their residents with a form that indicates the kind of adjustments that will need to be made to partnership distributive share income so that this form can then be provided to their partnerships.

The image shows a Schedule K-1 (Form 1065) for the year 2025. The form is titled "Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items". It includes sections for reporting various types of income and deductions, such as ordinary business income, self-employment income, and qualified dividends. The form also includes a section for the partner's capital account and a section for the partner's share of net unrecaptured section 1259 gain. The form is filled out with sample data, including a beginning and ending balance for the capital account and a net unrecaptured section 1259 gain of \$10,000.

INFORMATION REPORTING IS CRITICAL – BUT RULES COME FIRST



- State sourcing information (no blending)
- The rules are fairly clear
- Reporting requirements may not be sufficient
- States may need to provide forms allowing different reporting for different types of partners

The image shows a portion of the IRS Schedule K-1 (Form 1065) for the year 2025. The form is titled "Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items". It includes sections for reporting various types of income and deductions, such as ordinary business income, net rental real estate income, and qualified dividends. The form also includes a section for the partner's share of liabilities and a section for the partner's capital account analysis. The form is numbered 451123 and includes the IRS logo and the text "Department of the Treasury Internal Revenue Service".

INFORMATION REPORTING IS CRITICAL – BUT RULES COME FIRST



- State sourcing information - blending
 - **The rules may need clarifying** – especially with respect to computing the share of factors
 - Reporting requirements may not be sufficient
 - Information may vary where there are special or mandatory allocations

Schedule K-1 (Form 1065) 2025
Department of the Treasury Internal Revenue Service

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1 Ordinary business income (loss)	14 Self-employment earnings (loss)
2 Net rental real estate income (loss)	15 Credits
3 Other net rental income (loss)	16 Charitable contributions for services
4 Guaranteed payments for services	17 Alternative minimum tax (AMT) deduction
5 Total guaranteed payments	18 Interest income
6 Ordinary dividends	19 Tax-exempt income and nondeductible expenses
7 Royalties	20 Other information
8 Net short-term capital gain (loss)	21 Foreign taxes paid or accrued
9 Net long-term capital gain (loss)	22 Other deductions
10 Unrecaptured section 1250 gain	
11 Other income (loss)	
12 Section 179 deduction	
13 Other deductions	

Part I Information About the Partnership

Part II Information About the Partner

Partner's Capital Account Analysis

Beginning capital account	
Capital contributed during the year	
Current year net income (loss)	
Other income (loss) and expenses	
Withdrawals and distributions	
Ending capital account	

CRITICAL QUESTIONS

- What information should partners be required to provide to partnerships?
 - Should partners in a state requiring adjustments be required to provide to their partnerships (for transmission to lower tiers) a statement that certain adjustment information is required?
 - Can states design forms for that purpose – just summarizing the types of information that will be required.
 - For example – state decoupling from depreciation would require resident partners to provide to the partnership a statement of information needed to make the adjustment.
- Penalties and who is ultimately responsible.
 - Should partnerships be penalized if a partner that should apply blending fails to do so? (It seems this would be inappropriate.)
 - Should a partner be penalized if the partnership fails to provide information

BOTTOM LINE QUESTION

When the tax rules which apply to income or taxpayers effectively require that partners obtain certain information from a partnership which may be difficult in the case of a complex structure, do we come up with sufficient information-reporting systems, or do we simply waive the tax rules when it comes to that partnership income?

**FROM THE TAX
ADVISOR
WEBSITE**

State compliance for multitiered partnerships: Planning, communication, and execution can avoid common mistakes

From Patrick Walsh, CPA, Fairlawn, Ohio

August 30, 2025

- “A foundational step in managing state income tax compliance within a multitiered partnership structure is **developing a comprehensive understanding of the entire structure** and the specific needs of the stakeholders at each level. Without this clarity, the risk of inconsistencies, filing errors, or unintended changes in filing methodology increases significantly.”
- **“Equally important is the business activity conducted at each tier.** A partnership that merely holds an interest in a lower-tier investment may have vastly different compliance considerations than one that also operates an active trade or business. Commingling these activities without clearly delineating them on a tax return can create confusion not only for the preparer but also for state tax agencies reviewing the filing.”

**FROM THE TAX
ADVISOR
WEBSITE**

State compliance (Cont'd)

To mitigate these risks, communication must begin well in advance of any deadlines. Early discussions between the various tiers should address several key considerations:

- Which states the lower-tier entity intends to file in for the current year;
- Whether states will be added or exited in the current year due to changes in business activity or investments;
- Preliminary apportionment data and state-sourced income estimates;
- Character of income or losses (e.g., ordinary, capital, or guaranteed payments);
- Understanding income allocations throughout the structure;
- Anticipated state-level modifications;
- Composite and nonresident withholding plans (to opt in or to opt out); and
- Additional facts and circumstances that could impact filings (e.g., partner transactions or entity reorganizations).



Information Reporting

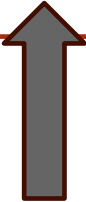
Are the draft requirements reasonable?

When to Blend

Is the UBP the right standard and how does it apply?

How to Blend

How is the partner's share of factors determined?



GENERAL COMMENTS



WHEN TO BLEND

IS THE UBP THE RIGHT STANDARD AND HOW DOES IT APPLY?

INITIAL RESPONSE – SUBJECT TO FURTHER DISCUSSION



BASICS:

- Only certain partners may blend
 - Not holding companies (no factors)
 - Not individual partners acting in individual capacity (no factors)
 - Not investment partnerships (see model)
- Again note—the default method of sourcing partnership income is to source at the partnership level—including apportionment using partnership apportionment factors.
- And states don't have to blend. But most states require blending and some refer to the unitary relationship between partner and partnership as the standard.

NOTES ON USE OF THE UNITARY BUSINESS PRINCIPLE (UBP) AS A STANDARD FOR BLENDING

- **As the white paper points out:**
 - **States are not limited to using apportionment only when they combine the entire income from unitary business activities conducted by separate entities but may, instead, apportion that income separately.**
 - **A single entity or taxpayer can have more than one unitary business activity from which income can be apportioned using separate factors.**
- **The model refers to the application of the UBP and provides very generally for its application to limit blending, but other limitations might also apply.**

THE PROBLEM IN USING THE UBP:

- Where does the UBP come from?
 - U.S. Supreme Court
- Has the U.S. Supreme Court ever –
 - Ruled the UBP is the appropriate standard for blending?
 - No.
 - Applied the UBP to sourcing a partner's distributive share income?
 - No.
 - Used the term “factor representation”?
 - No.

SO – HOW HAS THE UBP BEEN USED?

- **Issues to which the UBP has been applied:**
 - **State jurisdiction**
 - **Aggregation (entity combination)**
 - **Fair apportionment**
- **These issues are often inter-connected.**

JURISDICTION

See *ASARCO Inc. v. Idaho State Tax Com'n*, where the Court, commenting on Mobil's reference to the UBP as a "linchpin" said this:

“The constitutionality of a state tax levied on extraterritorial business operations thus turns on whether the out-of-state business activity can be characterized as a separate business with no in-state contacts or whether instead it is a part of a unitary enterprise doing business in the State.”

AGGREGATION

See *U. S. Steel Corp. v. Multistate Tax Commission* (1978), FN23, where the Court describes this as:

The “unitary business” technique involves calculating a corporate taxpayer’s income on the basis of all phases of the operation of a single enterprise The portion of that income attributable to activities within the taxing State is then determined by means of an apportionment formula. . . . ‘Combination of income’ involves applying the unitary business concept to separately incorporated entities engaged in a single enterprise.

- See also *Mobil Oil v. Vermont* (1980) which talks about the “linchpin” of apportionability – CITING *U.S. STEEL CORP V. MULTISTATE TAX COMM’N*
- But this aggregation is not constitutionally required.

FAIR APPORTIONMENT

- *Container Corp. of Am. v. Franchise Tax Bd.* later speaks to applying an apportionment to the income of a unitary business:

“Such an apportionment formula must . . . be fair. . . . The first, and again obvious, component . . . is what might be called internal consistency The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. . . .

[Citing *Moorman*] we will strike down the application of an apportionment formula if the taxpayer can prove “by ‘clear and cogent evidence’ that the income attributed to the State is in fact ‘out of all appropriate proportions to the business transacted in that State,’ . . .”

BLENDING IS NOT ABOUT JURISDICTION

States have jurisdiction to use “separate apportionment” (using the partnership factors) to source the partnership’s multistate income and to separately source the partners’ own income.

BLENDING IS ONLY PARTIALLY ABOUT AGGREGATION

- Partnerships don't (can't) just file a combined return.
- Whenever there are partner-partnership transactions, the effects are offset to the extent the partner's distributive share income is included with their own net income.

Example: Corp Partner buys services from Partnership (properly treated as Sec. 707(a) transactions). Corp has expense and Partnership has income. Assuming there are no special allocations of these items, Corp's expense from the purchases will be offset to the extent of its distributive share (which will include Partnership's sales/income).

BLENDING IS ONLY PARTIALLY ABOUT AGGREGATION

- But without blending, would intercompany receipts necessarily be excluded from the partnership's receipts factor to the extent of the partner's distributive share of the partnership's related income?
- Also, the effect of aggregation through the inclusion of distributive share is limited to the extent to which that distributive share, and the partner's other income, are both sourced to a particular state.

Example: Assume the same facts as the prior example except that Partnership sources its distributive share to State X (so that Corp's share is also sourced to State X), but Corp sources its other income to State Y.

BLENDING IS MORE ABOUT FAIR APPORTIONMENT

- Assume a partner engages in the **same income generating activity** both directly and through a partnership. If the state would include both the direct and distributive share income from that activity in the apportionable base, then should the same types of factors that would otherwise be included also be used when apportioning that base?
- While the U.S. Supreme Court has never addressed factor representation per se, a few state courts have ruled supporting “factor representation” generally.
- UDITPA also contains Sec. 18 which allows variation in the approach used in order to “fairly represent the extent of the taxpayer’s business **activity** in this State.”

MTC MODEL ALLOCATION AND APPORTIONMENT REGULATIONS

Current version available here: <https://www.mtc.gov/uniformity/adopted-uniformity-recommendations/model-general-allocation-and-apportionment-regulations/>

- Notes the relationship of the UBP to UDITPA's functional and transactional tests.
- Provides that: **"A single entity may have more than one unitary business"** and in those cases "the apportionable income of each unitary business is then apportioned by a formula that takes into consideration the in-state and the out-of-state factors that relate to the respective unitary business"
- Notes that ownership rules apply to determine when separate corporations are members of a commonly controlled group such that their income may be unitary.
- In these regulations, **the only mention of partnerships are in the determination of the ownership of the share of voting stock** and the attribution of those voting rights in cases where stock is held by or through partnerships.

MTC COMBINED FILING MODELS

Speaking of combined filing . . . here are provisions from the MTC's adopted combined filing models:

Joyce Model – here: <https://mtc.gov/wp-content/uploads/2023/02/Combined-Reporting-FINAL-version.pdf>

Section 1. Definitions.

...

C. “Corporation” means any corporation . . . which if it were **doing business** in this state would be a “taxpayer.” The **business conducted by a partnership which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation’s distributive share** of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation.

▪

COMBINED FILING MODELS

Joyce Model – here: <https://mtc.gov/wp-content/uploads/2023/02/Combined-Reporting-FINAL-version.pdf>

Section 1. Definitions.

...

F. “Unitary business” means [a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.]

Drafter’s note: This portion of the definition is drafted to follow MTC Reg. IV(b), defining a “unitary business.” .

. . Any business conducted by a partnership 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 corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this section 1.F. are satisfied, to wit: there is a synergy, and exchange and flow of value between the two parts of the business and the two corporations are members of the same commonly controlled group.

COMBINED FILING MODELS

Joyce Model

Section 3. Determination of taxable income or loss using combined report.

...

B. Determination of taxpayer's share of the business income of a combined group apportionable to this State.

The taxpayer's share of the business income apportionable to this State of each combined group of which it is a member shall be the product of:

i. the business income of the combined group, determined under Section 3.C., and

ii. the taxpayer member's apportionment percentage, . . . 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 3.C.ii.(c). and the denominator of which is the amount of the partnership's total unitary income.

COMBINED FILING MODELS

Finnigan Model – here: <https://mtc.gov/wp-content/uploads/2025/12/Final-finnigan-Model-1-correction-with-resolution-for-posting.pdf>.

Section 3. Determination of combined group income subject to tax

B. Allocation and apportionment

...

iv. If a member of the combined group holds a partnership interest from which it derives apportionable income, the share of the partnership's apportionment factor[s] to be included in the apportionment factor[s] of the group is determined by multiplying the partnership's factor[s] by a ratio the numerator of which is the amount of the partnership's apportionable income properly included in the member's income, whether received directly or indirectly, and including any guaranteed payments, and the denominator of which is the amount of the partnership's total apportionable income. If a member of the combined group directly or indirectly receives an allocation of a partnership tax item, such as an item of loss or expense, so that it is not possible to determine the member's share of apportionable income, the [Director] may provide rules for inclusion of particular partnership factors, or portions of factors, in the combined group's factors.

PARTNERSHIP EXAMPLES

- Assume:
 - Corp rents property and provides services to those who lease the property in State X.
 - Corp holds an interest in Partnership which owns similar property in State Y which Partnership leases to customers.
 - Corp provides the same types of services to Partnership's customers leasing its property in State Y.
 - Corp receives a share of Partnership's rental income.
- Questions:
 - Should Corp include a share of the Partnership's rental receipts sourced to State Y in Corp's apportionment factor applied to its blended apportionable income including its share of Partnership income?
 - Does it matter whether Corp is a majority owner of Partnership?
 - Does it matter whether Corp is involved in the management of Partnership?

PARTNERSHIP EXAMPLES

- Assume:
 - Corp has a business in State X.
 - Corp holds an interest in Partnership 1 (P1) which is involved in two businesses through Partnership 2 (P2) and Partnership 3 (P3), which operate entirely in State Y.
 - Corp's and P3's businesses are closely related and Corp benefits from and participates in the activities of P3.
 - Corp's distributive share from P1 includes a distributive share from P3.
- Questions:
 - Should Corp include a share of P3's factors from State Y in its apportionment formula applied to the blended apportionable income from its own activities and its distributive share from P1 that is the income from P3?
 - Does it matter whether Corp is an indirect partner in P3?

PARTNERSHIP EXAMPLES

- **Assume:**
 - Corp has a business in State X which has no income tax.
 - Corp holds a minority interest in Partnership which operates in State Y which has an income tax.
 - Corp does not control Partnership.
 - Corp has employees that perform certain operational tasks and has an exclusive contract with Partnership to provide Partnership those same operational services which are necessary for Partnership to serve its own customers.
 - The transaction between Corp and Partnership is treated as a Sec. 707(a) transaction between unrelated parties.

- **Questions:**
 - Should Corp blend?
 - Does it matter whether Corp's income is effectively offset by its share of the related expense in its distributive share of Partnership's income?

PARTNERSHIP EXAMPLES

- **Assume:**
 - Corp has a business in State X which has no income tax.
 - Corp holds a minority interest in Partnership which operates in State X and State Y which has an income tax.
 - Corp controls Partnership.
 - Corp receives a special allocation of Partnership income related only to activities in State X.
- **Questions:**
 - If Corp blends should it blend all of the factors from Partnership or only those related to the activities in State X?
 - Does it matter whether Partnership's activities in State X and State Y are unitary?

PROPOSED DRAFT MODEL PROVISIONS – PART VI.

Sufficient Unitary Relationship

The term “sufficient unitary relationship” as used in this section refers to the necessary relationship between items of income and the apportionment factors used to source that income, especially in the pass-through tax system used to impose tax on partners for their shares of partnership income. The term takes into account all the facts and circumstances relevant to the sourcing treatment of particular items of income including:

A. The relationship between the partnership that recognizes the income or items and the partners, including tiered partners, or other entities that are engaged in the related business activities generating other income or items, including:

1. The extent of actual common control, direct or indirect, held or exercised over the business activities, regardless of the share of partnership capital held;
2. The extent to which related activities are integrated or coordinated;
3. The extent to which resources and costs are shared; and
4. The extent of transactions or flows of value between the entities.

B. The extent of common use by the partnership and partners, including tiered partners, of assets held by the partnership or partners.

C. The nature of common use by the partnership and partners, including tiered partners, of assets held by the partnership or partners.

BOTTOM LINE QUESTION

Is this sufficient as a general framework for states to use to create rules and other guidance for applying the UBP in the partnership pass-through tax context?

Is the UBP the right standard or are there other rules or limitations to be considered for purposes of blending?



QUESTIONS & THOUGHTS

TO BE CONTINUED . . .

