Recent SALT Developments Impacting Multistate Pass-Through Entities

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Agenda

I. Update on MTC Project on State Taxation of Partnerships
II. Developments in State Pass-Through Entity Taxes
III. Federal Partnership Audit Rules & State Implications
IV. Pass-Through Entity Gain Cases
V. Other Noteworthy Developments

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I. Status Report: Multistate Tax Commission Project on State Taxation of Partnerships

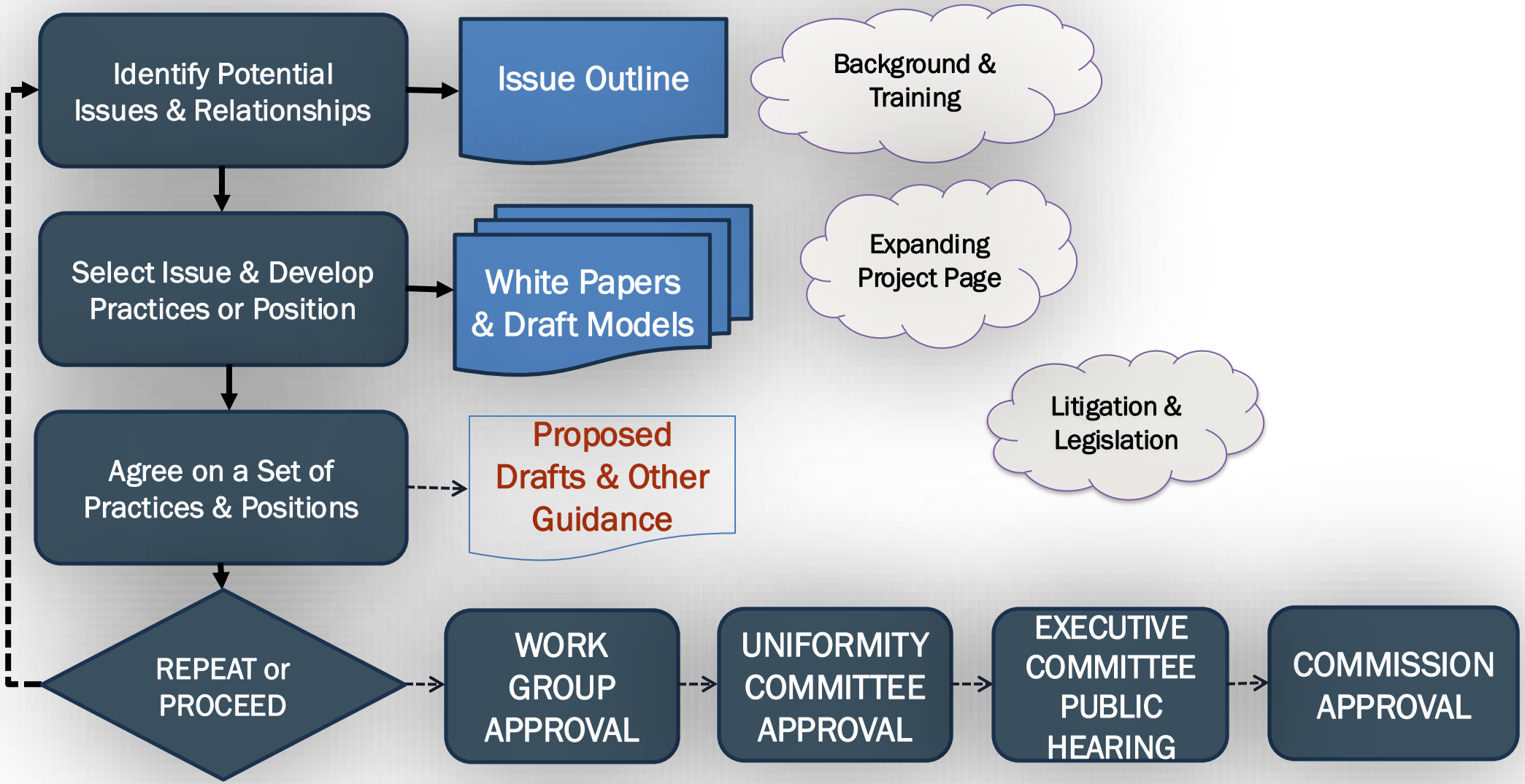
Began 2021

See project page here: https://www.mtc.gov/uniformity/project-on-state-taxation-of-partnerships-

[With special thanks to Helen Hecht, Uniformity Counsel to the MTC, for allowing us to borrow from her COST 2024 Annual Meeting slide deck.]

General Work Group Process

With regular project participants from 21 states.



Status - Overview

	Initial Discussion	State and Other Research	Define Issues & Scope	Analyze Alternatives – White Paper	Draft Models or Recommendations	Refer Recommend-ations to Uniformity Committee
Investment Partnerships	✓	✓	✓	✓	✓	
Guaranteed Payments for Services	✓	✓	✓	✓	✓	
Sourcing in Complex Partnership Structures	✓	✓	✓			

Work To date

Issue Outline

- Comprehensive list of the state tax issues raised by the pass-through tax system that states must address including:
  - Nexus
  - Tax base
  - Sourcing
  - Administrative
  - Etc.

Sourcing of Income from Investment Partnerships

- White Paper and Draft Model –
  - If the partnership meets the definition of an investment partnership,
  - Then nonresident partners not involved in the partnership activities would source that partnership's income by looking through to the underlying assets and activities.

Sourcing of Guaranteed Payments for Services

- White Paper and Draft Model –
  - Guaranteed payments for services are sourced in the same way as distributive share.
  - A credit for tax paid is provided if a resident is subject to tax in another state on the basis of where services are performed.

Overview of State Tax Guidance on Sourcing in Tiered Partnership Structures

- We researched to see what states have done to address the sourcing of partnership income in tiered structures generally.
- We looked in state tax statutes, regulations, guidance, tax form instructions, and case law.
- We compiled this research into a draft document containing examples of state tax sourcing rules, pass-through entity tax rules, and withholding/composite return tax rules relevant to tiered partnerships.
- That research is being updated as we get additional information.
- **Our research should not be relied on as tax advice. For specific questions, please contact your state department of revenue and/or tax advisor*.

Outline

I. Scope

The white paper would address sourcing where the partner is a corporation, the partnership is a tiered structure, or situations where there are intercompany transactions or special allocations. It would exclude investment partnerships but include guaranteed payments (sourced in the same way as distributive share).

II. Essential Terms

III. Importance of the Attribution Principle

Outline (cont'd)

IV. Sourcing Non-Apportionable Partnership Income - Generally

A. Determination of non-apportionable income
B. Sourcing non-apportionable income

V. Sourcing Apportionable Partnership Income

A. Corporate and tiered partners – need for blended apportionment
B. How blended apportionment may be applied
C. When blended apportionment may be applied and legal and other limitations

Outline (cont'd)

VI. Anti-Abuse Rules

A. Special allocations and substantial economic effect

B. Other – including equitable apportionment rules

VII. Administrative Issues

A. How information is reported by partnerships and partners

B. How withholding may be affected

C. How composite returns or PTE taxes may be affected

VIII. Summary of State Research

A. Treatment of corporate and tiered partnerships

B. Treatment of special allocations

C. Anti-abuse rules

What's Next?

"MTC Group Floats Extending Partnership Nexus to Partners"
By Paul Williams, Law360 SALT (10/18/23)

"States that have nexus over a partnership should also be considered to have nexus over its partners, a Multistate Tax Commission attorney said Wednesday in proposing principles for a work group project seeking uniformity on state taxation of partnerships."

Helen Hecht, the MTC's uniformity counsel, floated including the concept of extending nexus over a partnership to its partners in a **draft framework** she presented that would guide the work group's discussions as it continues to make recommendations regarding how states can tax partnerships.

What's Next?

"MTC Group Floats Extending Partnership Nexus to Partners" By Paul Williams, Law360 SALT (10/18/23) (Cont.)

"The question is: Does the state by virtue of having nexus over the partnership also have nexus over partners? And we would assert here that it does," she said during a work group meeting, held online.

Hecht acknowledged that some state courts have found there are constitutional limitations over when states can tax partners. However, she said there has been "some evolution over time" on the subject and there is scant U.S. Supreme Court precedent on the matter.

"There's a lot of uncertainty here," she said, but added that there "are also good arguments to be made" in support of the concept..."

II. DEVELOPMENTS IN STATE PTE TAXES

Ignoring the states that don't impose an owner-level personal income tax*, which states have not yet passed a PTE tax?

- Proposed: ME, PA, VT
  - Maine, LD 1891
  - Pennsylvania, SB 659/HR 1584
  - Vermont, SB 45
- Not yet proposed: DC, DE, ND

*AK, FL, NH, NV, SD, TN, TX, WA, WY

Maine

- Governor Mills approved a study (April 2024) to determine the impact of a PTE tax on both a mandatory and elective basis. The Office of Tax Policy must submit this report by January 15, 2025.

Pennsylvania

- Annual election on or before the original due date of return (Senate); on or before the fifteenth day of the fourth month of the entity's taxable year (House)
- Refundable credit (100%)
- Election only available to the extent the federal SALT cap is in place

Vermont

- Eligible entities must be owned by natural persons
- Annual election on or before the due date for filing the entity's return; revocable only until the due date of the return
- Refundable credit (90%)
- Election only available to the extent the federal SALT cap is in place

District of Columbia

No PTET formally proposed, but there is a tax overhaul proposal to be put to a vote.

A meeting was cancelled in July where the commission was expected to vote on the proposal. At the time these slides were prepared, we're hopeful for some movement at the October meeting.

Proposal includes:

- Child tax credit
- Property tax relief for homeowners and renters
- Repeal of the personal property tax
- Business activity tax
- Data excise tax

Recent Updates

Alabama

- HB 187 (April 2024) allows election to be made by return due date, including extensions.

Connecticut

- Reminder: HB 6941 (June 2023) made the PTET optional beginning with 2024 tax year.
- Elimination of the standard base measure; all electing PTE filers must use the alternative base:
  - CT source income PLUS portion of total "unsourced income" attributable to CT resident owners
- Composite filings reimposed when nonresident only CT source income is from PTE

Hawaii

- SB 2725 (June 2024) included several changes to the PTET:
  - "Qualified member" defined as individuals, trusts, or estates
  - Reduced rate to 9%
  - Nonrefundable credit carried forward until exhausted
- Tax Information Release No. 2024-01 (August 2024)

Recent Updates

Kansas

- Notice 24-14 (August 2024) summarized changes to the SALT Parity Act made with passing of SB 410:
  - Tax rate tied to highest rate applicable under KSA 79-32, 110(a)
  - Two options available for KS resident owners when calculating source income

Louisiana

- Revenue Information Bulletin No. 24-008 (February 2024) outlined eligible partnerships exempt from filing LA returns and confirms that partnerships with a PTET election in place are not exempt from filing.

Missouri

- HB 1912 (August 2024) revised provisions to the PTET passed in 2022:
  - "opt-out" election now available
  - QBI deduction allowed under IRC sec. 199A now "as allowed under state law"

Recent Updates

North Carolina

- Directive TA-23-1 (updated May 2024) confirmed that an amended taxed partnership election is not valid if filed after July 1, 2024.

West Virginia

- Effective April 30, 2024, Code of State Rules §§ 110-21G-1 through 110-21G-12 address WV PTET requirements and procedures.

Unforeseen Impacts?

- Taxability of refunds
  - AICPA FAQ (July 2024)
- Payments
  - Transferability of composite (or other) payments to PTET account
- Credit for taxes paid

- What will happen to SALT cap?
  - Schumer
  - Trump
  - Harris

- Which states will sunset their PTET?

III. FEDERAL PARTNERSHIP AUDIT RULES AND STATE IMPLICATIONS

Federal Partnership Audit Rules – Background

- The Bipartisan Budget Act of 2015 ("BBA") adopted new IRS audit procedures for "large" partnerships (including multi-member LLCs) effective for taxable years beginning after December 31, 2017
- The BBA contains special procedures to correct partnership returns called an Administrative Adjustment Request ("AAR")
  - To file an AAR, a partnership must:
    - File either (i) Form 1065X (if eligible to paper file) or (ii) Form 8082 along with Form 1065
    - Determine whether the requested adjustments result in an imputed underpayment (IU)
      - If the requested adjustments result in an IU, the partnership can pay the IU or push out the adjustments to its reviewed year partners
      - If any requested adjustments do not result in an IU, those adjustments must be pushed out to the reviewed year partners
  - If a push-out election is made, the partnership must furnish statements to its reviewed year partners using Form 8986 and file partnership adjustment tracking reports using Form 8985
  - An AAR may not be filed for a partnership tax year after the IRS mails a notice of administrative proceeding for that tax year

Federal Partnership Audit Rules —Roll-Out

- A 2023 US Government Accountability Office study found that the number of large partnerships increased almost 600% from 2002 to 2019, and of the 20,000 large partnership returns filed in 2019, only 54 were audited.
- IRS issued IR-2023-166 announcing that it will focus its compliance efforts on increasing scrutiny on partnerships, among other corporate and high-income taxpayers.
- IRS announcement states it plans to use Artificial Intelligence to aid in its identification of compliance risks.
- IRS opened 76 audits by December 2023 of the largest partnerships in the U.S., with an average of $10 billion in assets.
- In September, the IRS launched a new passthroughs unit that combines staff with passthrough expertise from LB&I and SB/SE Divisions. Taxpayers will start to see “a whole new level of partnership audits that are supported throughout the entire organization,” said Clifford Warren, IRS Office of Associate Chief Counsel (Passthroughs and Special Industries).

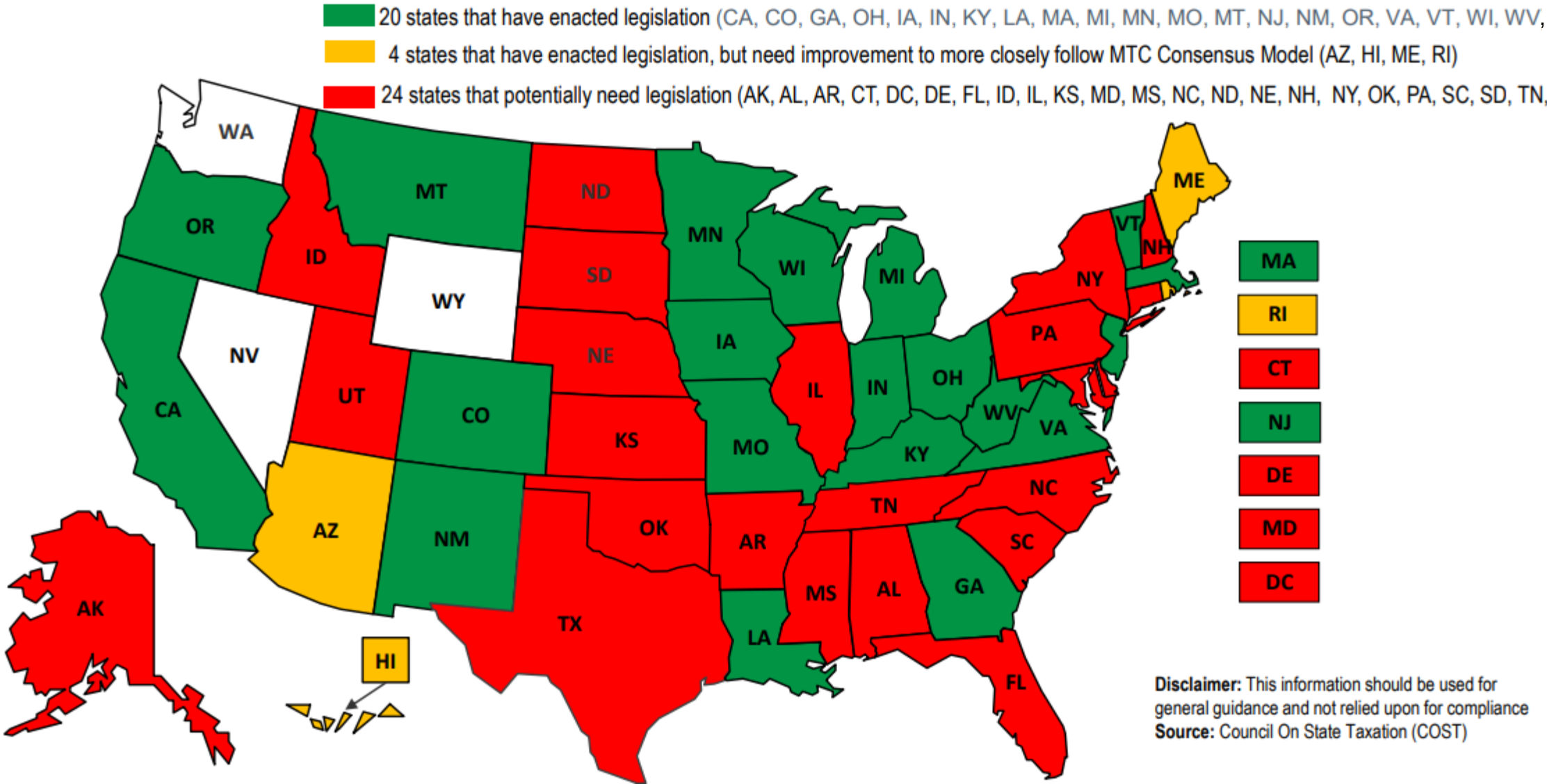
Federal Partnership Audit Rules – State Implications

As of August 2024, the following States have adopted specific rules relating to reporting federal adjustments pursuant to a BBA partnership audit:

Arizona	California	Colorado (Adjustments made on and after 1/1/2024)
Georgia	Hawaii	Indiana
Iowa	Kentucky	Louisiana
Maine	Massachusetts	Michigan
Minnesota	Missouri (Adjustments made on or after 1/1/2021)	Montana (Adjustments made after 3/31/2021)
New Jersey	New Mexico	Ohio
Oregon	Rhode Island	Vermont (Adjustments made on and after 7/1/2022)
Virginia	West Virginia	Wisconsin

- Statute of limitations and reporting deadlines for states may be different than BBA rules and procedures
- States that have adopted the federal provisions for BBA may have different state filing methods and procedures (i.e., states require partner and partnership to file amended returns)

Adoption of MTC Partnership Adjustment Model



Partnership Audit Rules —State Implications: MTC Model Statute

- Multistate Tax Commission (MTC) drafted a model statute for reporting final federal adjustments from federal partnership examinations and from administrative adjustment requests (AARs)
- The MTC received comments on the proposed model from multiple organizations, including ABA, COST, AICPA, TEI, and others
- One of the key differences in MTC Model versus federal rules is default payment method:
  - –MTC Model = Partners pay the adjustment
  - –BBA (federal) = Partnership pays the adjustment
- MTC Model adopts concept of partnership representative for state purposes
  - –The state partnership representative will default to the federal partnership representative unless otherwise specified

Partnership Audit Rules – MTC Model Rules

Default Reporting Timing and Payment Method:

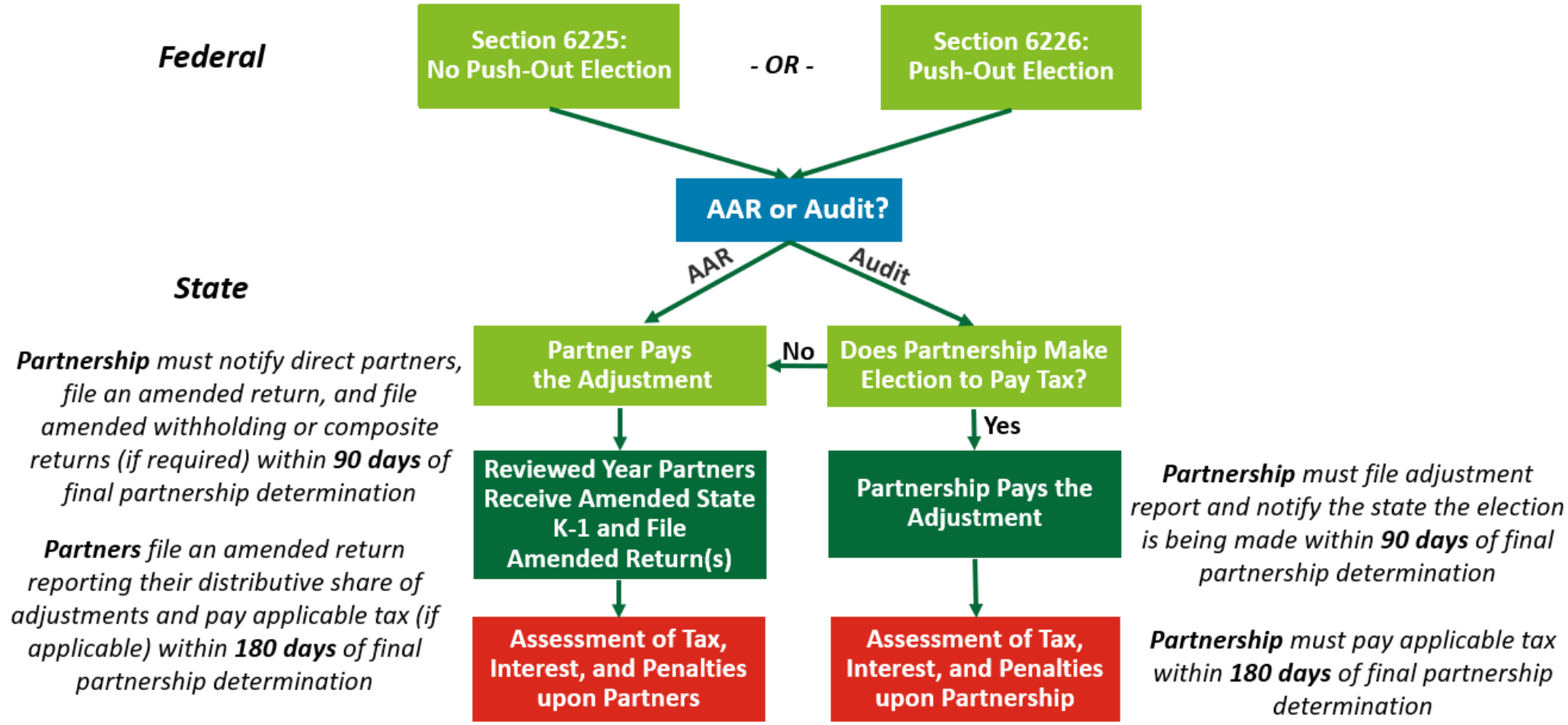
- **Within 90 days** of final partnership determination:
  - Partnership files a partnership adjustment report
  - Partnership notifies the direct partners
  - Partnership files amended composite/withholding tax return (if required) and pays applicable tax
- **Within 180 days** of final partnership determination
  - Direct partners file adjustment report reporting distributive share of adjustments
  - Direct partners pay any applicable tax, which is calculated as if properly reported
- Special reporting provisions for tiered partnerships
- Tiered direct partners or indirect partners shall make required reports and payments no later than 90 days after the time for filing and furnishing statements to tiered partners and their partners as established under IRC section 6226 **(*i.e.*, 90 days after the extended due date of the audited/AAR partnership's adjustment year tax return)**.

Partnership Audit Rules – MTC Model Rules: Partnership Pays Election Available for Final Federal Adjustments from Examinations

Reporting Timing and Payment Method—Affirmative Election for Partnership to Pay

- Within 90 days–Partnership files adjustment report and notifies the state that it is making the election
- Within 180 days–Partnership pays the amount of the adjustment
- Computing partnership-level adjustment:
  - Exclude amounts attributable to direct exempt partners
  - Distributive shares to direct corporate partners: Apportion and allocate adjustments and multiply by highest tax rate
  - Distributive shares to non-resident direct partners: State sourced income and multiply by highest tax rate
  - Distributive share to resident direct partners: Amount by highest tax rate
  - Distributive share to tiered partners: Three step process
  - The partnership may not elect to pay an amount stemming from an AAR

Partnership Audit Rules – MTC Model Rules Illustrated



IV. PASS-THROUGH ENTITY GAIN CASES

PTE Gain Cases

Investee Apportionment

When a PTE subsidiary doing business in a state is sold, the taxing state:

- Seeks to tax parent's gain on the sale.
- Uses subsidiary's contacts with state to assert nexus over parent.
- Uses benefits provided to subsidiary to assert nexus over parent's gain.
- Uses subsidiary's factors to apportion parent's gain.
- Often challenges Constitutional requirement that parent and subsidiary be part of a unitary business

Welch v. Comm'r of Revenue, ATB 2023-391, No. C339531 (Mass. App. Tax Bd., Nov. 29, 2023)

- Welch was the co-founder of a Delaware operating corporation based in Massachusetts and was heavily involved in its operations, including holding multiple high-level positions throughout his tenure.
- After building up the value of the corporation, Welch resigned, moved out of Massachusetts, became a resident of New Hampshire, and quickly thereafter sold his founder's stock for a gain.
- Welch filed a part-year resident Massachusetts return and excluded the gain from his Massachusetts taxable income because it was not state-sourced.
- The Commonwealth issued a Notice of Assessment assessing tax on the entire gain. This assessment was based on the department's determination that the income generated from the sale of the stock was compensation for Welch's work as a founder and employee of the company.
- The ATB upheld the assessment and ruled that the gain was Massachusetts-source income subject to taxation the value generated was inextricably connected to Welch's substantial active contributions to the corporation in his capacity as an employee.

PTE Gain Cases

***Matter of Alvaco Trading Company, Inc.*, Cal. Off. Tax App. Nos. 220410259, 220410261, 220410262, 220410263 (Nonprecedential, Jan. 23, 2024)**

- In 2007, Avalco contributed its operating assets to form subsidiary ABB/Con-Cise Optical Group, LLC, and received 55% equity interest in exchange.
- Alvaco, an S Corporation, had no sales, payroll, or property sourced to California (other than from ABB/Con-Cise), and no other business operations.
- Alvaco sold 41.54% of ABB/Con-Cise in 2012, retaining 13.46%.
- ABB/Con-Cise was doing business in California and had a 29.21% California apportionment ratio in the year of sale.

PTE Gain Cases

***Matter of Alvaco Trading Company, Inc.*, Cal. Off. Tax App. Nos. 220410259, 220410261, 220410262, 220410263 (Nonprecedential, Jan. 23, 2024)**

- ALJ found:
  - Alvaco and ABB/Con-Cise Optical Group LLC were engaged in a unitary business.
  - Alvaco's gain is business income under the functional test.
  - Because Alvaco's shareholders are individuals, Cal. Code Regs., tit. 18, § 17951-4 applies.
  - Cal. Code Regs., tit. 18, § 17951-4 has the "dignity of law," applies over Rev. & Tax. Code § 17952, so Alvaco's gain is apportioned to California using ABB's factors.
  - Did not address constitutional claims for lack of jurisdiction.

PTE Gain Cases

Rayant & Fields v. Harris, Ohio Dep't Taxation Final Determination (Mar. 28, 2024)

- Ohio Rev. Code 5747.212 requires 20% or greater owner of equity voting rights in certain closely-held businesses to apportion gain on sale of an interest using avg. apportionment factors for current and two preceding years (investee apportionment).
  - *Corrigan v. Testa*, 149 Ohio St.3d 18, 2016-Ohio-2805, *T. Ryan Legg Irrevocable Trust v. Testa*, 149 Ohio St.3d 376, 2016-Ohio-8418.
- Ohio has Business Income Deduction & 3% tax rate; Ohio Rev. Code 5747.01(B) definition of "Business Income" amended in 2022 and applicable to all years open to audit.
  - "Business income" defined as including when sale of equity is treated as an asset sale and/or seller materially participated in the business in year of sale or preceding five years under 26 C.F.R. § 1.469-5T.

PTE Gain Cases

Rayant & Fields v. Harris, Ohio Dep't Taxation Final Determination (Mar. 28, 2024)

- Nonresidents sold 25% interest in Rodan & Fields in 2018, sourced gain under Ohio Rev. Code 5747.212, filed timely refund claim on the basis of *Corrigan.*
- Department of Taxation distinguished *Corrigan* and found Ohio Rev. Code 5747.01(B) also applicable:
  - Dr. Fields founded, developed products for, acted as spokesperson for the company.
  - Rayant & Fields were members of the board of directors and received large guaranteed payment.
  - Considered active, rather than passive investors in the company for federal income tax purposes, on IRS Form 1040 Schedule E and Form 8960.
  - Dr. Fields' activities attributed to Dr. Rayant under 26 C.F.R. § 1.469-5T.
- Department granted partial refund, applying 3% rate to Ohio Rev. Code 5747.212 income; taxpayers appealed to Board of Tax Appeals, and case was jointly remanded in August.

S.C. Private Letter Ruling #24-1 (Feb. 21, 2024)

How should the sale of an interest in a multistate partnership doing business in SC be reported for income tax?

- South Carolina resident individual owned an interest in Management LLC, which owned 49% of Operating LLC.
- Both Management LLC and Operating LLC were treated as partnerships for income tax purposes.
- Individual was actively engaged in the management of Management LLC, and Management LLC performed all management functions for Operating LLC.
- South Carolina DOR determined that the resident individual was required to apportion gain from the direct sale of his interest in Management LLC because of his active role in the business.
- To determine the appropriate apportionment factor, South Carolina looked to the underlying activities of the Operating LLC because the two companies were unitary; a 2.4% factor.
- Why does this matter? South Carolina residents are taxed on their worldwide personal service income and their other income allocated or apportioned to South Carolina.

V. MISCELLANEOUS – RECENT SALT DEVELOPMENTS AFFECTING PTEs

Other Recent Developments

CarMax Auto Superstores, Inc. v. S.C. Dep't of Revenue, 2024 SC ALJ LEXIS 194, 21-ALJ17-0182-CC (Jul. 12, 2024)

- CarMax Auto Superstores, Inc. ("CarMax East"), challenged combined unitary reporting and $2.2 million corporate income tax assessment.
- Prior to 2004 reorganization, CarMax East owned and operated CarMax stores in the Eastern U.S., including South Carolina.
- After reorganization, it formed an LLC taxed as a partnership, CarMax Business Services, LLC ("CBS"), to perform back-office services for the stores and received a management fee in return.
- The other CBS member, CarMax Auto Superstores West Coast, Inc. ("CarMax West"), under common ownership with CarMax East, contributed high-value business intangibles, real estate and IP to CBS on its formation – CarMax West held a 93.5% interest in CBS, while CarMax East held only 6.5%.
- CBS's income from management fees primarily flowed to CarMax West, though CarMax East had more business activity in South Carolina.

Other Recent Developments

CarMax Auto Superstores, Inc. v. S.C. Dep't of Revenue, 2024 SC ALJ LEXIS 194, 21-ALJ17-0182-CC (Jul. 12, 2024)

- S.C. Admin. Law Court ("ALC") determined that prior to CarMax West contributing the assets to CBS, they were transferred to CarMax West by CarMax East in a transaction not at arms' length.
- ALC found value from the contribution of the intangibles should be reallocated to CarMax East.
- Despite transfer pricing studies, ALC found CBS management fee was unreliable.
- ALC also found standard apportionment formula and separate reporting did not fairly represent CarMax East's income in South Carolina, and that application of combined unitary reporting was reasonable.
- However, because the Department of Revenue failed to divide the taxable income attributable to South Carolina between CarMax East and CarMax West as required by *Finnigan*, the ALC remanded the case to the Department for further proceedings.

California Minimum Tax Litigation

Bahl Media, LLC v. Franchise Tax Bd. , Cal. Super. Ct., No. CGC-16-554150, (Jan. 25, 2024)

- *Swart Enters., Inc. v. Franchise Tax Bd.*, 7 Cal.App.5th 497, 212 Cal.Rptr.3d 670 (Cal. App., 2017) held a nonresident investor with no other connection to California that owned a 0.2% non-managing interest in a California LLC was not "doing business" in California, and was not obligated to pay California's $800 Minimum Tax.
- Neither Wein Realty, LLC nor Bahl Media, LLC ever had offices, employees, or property in California, neither was registered to do business in California, and neither did any business of their own in California.
- Wein Realty, LLC, directly owned a non-managing investment interest in a California LLC, while Bahl Media, LLC, held an interest in a New York LLC that owned a non-managing investment interest in an LLC registered to do business in California.

California Minimum Tax Litigation

Bahl Media, LLC v. Franchise Tax Bd. , Cal. Super. Ct., No. CGC-16-554150, (Jan. 25, 2024)

- Wein Realty, LLC and Bahl Media, LLC both paid the $800 Minimum Tax and applied for refunds, which the California Franchise Tax Board denied.
- Plaintiffs contend: (1) they are not “doing business” under Rev. & Tax Code § 23101 where their only California connection is a non-managing interest in a California LLC; (2) The Minimum Tax violates the Commerce Clause because it is not fairly apportioned, violates internal and external consistency, and discriminates against interstate commerce; and (3) ownership of a non-managing interest is insufficient to establish nexus under the Commerce Clause or Due Process Clause
- The California Superior Court granted plaintiffs motion to certify a class on January 25, 2024.
- Franchise Tax Board and Plaintiffs filed motions for summary judgment on July 22, 2024.
- Court heard arguments on October 9, and trial is scheduled for December 2.

Transfer Taxes & Entity Transactions

Vornado 3040 M Street LLC v. D.C., D.C. Ct. App., Dkt. No. 22-TX-0434 (Jul. 25, 2024)

- Vornado 3040 M Street, LLC ("M Street") formed M Street EAT II ("EAT II") and loaned it money to acquire property for an IRC § 1031 reverse like-kind exchange.
- EAT II acquired the property, but the transaction failed to get the tax-advantaged result desired, so all interests in EAT II were transferred to M Street, and EAT II merged into M Street in 2007.
- In 2019, M Street sought to transfer the property, and the District of Columbia would not record the deed until M Street paid the tax due on the 2007 transfer to it.
- M Street paid and sought a refund, which the City denied.
- The District of Columbia Code requires that: "At the time a deed…is submitted for recordation, it shall be taxed at the rate of 1.1%." D.C. Code Ann. § 42-1103(a)(1).

Transfer Taxes & Entity Transactions

Vornado 3040 M Street LLC v. D.C., D.C. Ct. App., Dkt. No. 22-TX-0434 (Jul. 25, 2024)

- Recordation of Economic Interests Act of 1989 (REI Act) provides deed tax exemptions for:
  - (1) Transactions when the ultimate ownership does not change (9 D.C.M.R. § 523.1);
  - (2) When there is a mere change in identity (9 D.C.M.R. § 523.3); and
  - (3) Transactions in complete liquidation of a wholly-owned subsidiary (9 D.C.M.R. § 520.2).
- District of Columbia Business Organizations Code § 29-202.06(3) vests title to property of each merging entity in the surviving entity "without transfer."
- Court upheld denial because the 2007 merger resulted in the transfer of legal title in real property, which is taxable under 9 D.C.M.R. § 502.1a, *Cowan v. District of Columbia Department of Finance and Revenue*, 454 A.2d 814 (D.C. 1983) (per curiam), and *Columbia Realty Venture v. District of Columbia*, 433 A.2d 1075 (D.C. 1981).

Washington Tax Determination 21-0190, 43 WTD 32 (Sept. 9, 2024)

- Washington Real Estate Excise Tax ("REET") is imposed on each sale of real property. Wash. Rev. Code § 82.45.060.
- Taxpayer LLC owned real property, with Members A and B each owning 10% of the LLC.
- Members A and B created a separate holding company in which each owned a 50% interest.
- The holding company then created a subsidiary.
- LLC transferred a 20% interest in the real property to the subsidiary.
- The LLC claimed two REET exemptions on its DOR filings:
  - (1) Nonrecognition on distribution to a partner (Wash. Adm. Code 458-61A-212(2)(f)); and
  - (2) Mere change in identity or form of ownership on Members' contribution to Subsidiary (Wash. Adm. Code 458-61A-211).

Transfer Taxes & Entity Transactions

Washington Tax Determination 21-0190, 43 WTD 32 (Sept. 9, 2024)

- In 2020, the Washington DOR audited, denied the exemption, and assessed tax.
- The LLC claimed there were two exempt transfers: A distribution from the LLC to Members A & B, and a contribution from Members A & B to the subsidiary.
- The DOR wanted separate REET affidavits for each transfer, and affirmed assessment because the LLC's federal income tax returns and operating agreement did not reflect an ownership interest change: A&B ostensibly retained their 20% interest in the LLC, and held their interests through the subsidiary – effectively having a 36% interest in the property.
- Moreover, property was deeded to the subsidiary, and the subsidiary did not have any interest in the LLC, so the distribution to the subsidiary could not have been to a partner.

Investment Partnerships

Illinois Admin. Regulations Amended Effective Jul. 11, 2024

86 Ill. Adm. Reg. § 100.9730

- "Investment Partnerships" exempted from Illinois income taxation under the Rule.
  - Definition limited to those satisfying a 90% of assets test and a 90% of gross income test.
- For tax years after 12/31/23, definition of "Investment Partnership" amended to:
  - Broaden permitted sources of income under the gross income test to include distributive shares of partnership income from lower-tier partnership interests meeting the definition of a "qualifying investment security."
  - Clarify that "gross income" does not include income from partnerships operating at a federal taxable loss.
  - Eliminate the requirement that the partnership not be a dealer in qualifying investment securities.
- For tax years after 12/31/23, definition of "Qualifying Investment Securities" amended to:
  - Include "Commodities" (not described in IRC § 1221(a)(1)) or futures, forwards, and options with respect to such commodities, except for those with respect to which the partnership acts as a dealer, i.e., inventory.

Investment Partnerships

Illinois Admin. Regulations Amended Effective Jul. 11, 2024

86 Ill. Adm. Reg. § 100.7034

- For taxable years after 12/31/23 an "Investment Partnership" member of other partnerships with Illinois income must withhold Illinois tax from each nonresident partner.
  - Certificate of Exemption for Pass-through Withholding, Form IL-1000-E, not applicable.
  - Applies to business income and nonbusiness income that would be sourced to Illinois under partnership rules.
  - Current year Illinois-source losses from lower-tier partnerships may reduce withholding obligations.
  - Investment Partnership may claim credit for entity-level PTE taxes of electing lower-tier partnerships.
  - Tax rates parallel those applicable to the type of partner: 4.95% for individuals (& PTEs), 7% for corporations.
  - Nonresident partners entitled to credit for tax withheld on business income.
  - Withholding credits flow up in tiered structures, including to resident partners and nonresident entities commercially domiciled in Illinois.

2023 - 2024 Tennessee PTE Developments

Tennessee

- On May 11, 2023, but with a delayed effective date, Gov. Bill Lee signed into law the Tennessee Works Tax Act with sweeping tax changes:
  - Single sales factor phase-in over three years, to be fully phased-in for tax years beginning on or after December 31, 2025,
  - Bonus depreciation conformity for assets purchased on or after January 1, 2023,
  - Standard deduction for excise tax introduced for tax years ending on or after December 31, 2024: lesser of net earnings or $50,000,
  - Beginning with tax years ending on or after December 31, 2024, up to $500,000 property exclusion from franchise tax base.

Corporate Transparency Act of 2021

- **Part of federal anti-money laundering effort (31 U.S.C. §5336)**

  Final rule on beneficial ownership reporting requirements released on September 29, 2022, and amended August 3, 2023 (effective Jan. 1, 2024)

  Preliminary questions for you/your clients:

  --Who will file the initial registration with the Financial Crimes Enforcement Network ("FinCEN") (which subsumes deciding whether the entity qualifies for one of the exemptions)?

  --Who will monitor ongoing compliance (e.g., ownership of the reporting company) and filing requirements?

  --Reporting companies formed prior to the effective date of the final regulations will have until December 31, 2024 to comply. But reporting companies formed on or after the effective date will be required to report the beneficial ownership information within 90 days (30 days after 2024) after formation or registration.

  --Any change in reported information must be reported to FinCEN within thirty days after the change.

More on CTA: Will States Follow Suit?

By default many small businesses (or their advisers) will be forced to register – and file periodically – with FinCEN (IRS). Estimated to be 32.6 million filings in 2024 and 5-6 million filings each year thereafter (conservatively). Actual filings so far this year are drastically less.

AICPA leading a large coalition of professional service organizations and tax prep firms seeking to at least delay the effective date.

More on CTA: Will States Follow Suit?

Recall the initial New York legislation, the New York LLC Transparency Act (AB 3484A, June 20, 2023), mimicked CTA in many ways but went beyond its basic tenet of taxpayer confidentiality. Ultimate beneficial owners (UBO) information would be posted on a searchable data base – available for all to see UNLESS a waiver is requested/granted. Only applied to LLCs, did not become effective until one year after Gov. signs bill into law, and penalties were relatively small.

After having the public access provisions greatly limited, Gov. Hochul signed the revised bill into law last December, but it didn’t last long . . .

New York LLC Transparency Act, version 2.0

On March 1, 2024, Governor Hochul signed a revised version of the 2023 Act into law, repealing the original version she signed in December. Most importantly the new law delays the effective date of the 2023 Act until January 1, 2026 (from January 1, 2025). Thus, domestic LLCs organized in or foreign LLCs authorized to do business in New York before 1/1/26 will have until 1/1/27 to make their initial filings, but those organized or authorized to do business on or after 1/1/26 will have only 30 days from the date of filing to comply with the new reporting requirements.

Thankfully, access to the BOI will still be maintained by the NY Department of State in a secure, confidential internal database that will only be accessible to law enforcement throughout the state, by court order, or by voluntary consent of a beneficial owner. Non-exempt LLCs will also be required to annually confirm their BOI on file or update their initial BOI or attest that they qualify for a continuing exemption.

Currently New York is the only state to have enacted CTA-like reporting requirements although CA and MA have proposed similar legislation, and we fear that a handful of other states may follow suit. Query what happens to the New York law if the CTA is eventually ruled unconstitutional or substantially amended if not repealed. There are a number of pending cases around the U.S. and several bills in Congress that would do just that if successful.

Questions?

Thank You!

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