The Continuing Struggle to Make Sense of Multistate Taxation of Pass-Through Entities

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Agenda

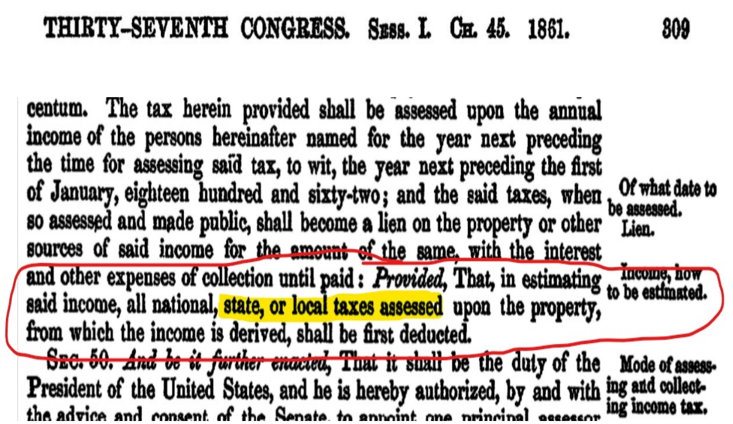
- Passthrough Entity-Level Taxes: A year later
- The MTC's Ambitious New Partnership Tax Project
- Apportionment of Pass-Through Entity Income: Gain from the Sale of Entity Interests
- Miscellaneous

PASSTHROUGH ENTITY-LEVEL TAXES: A YEAR LATER

29th ANNUAL
PAUL J. HARTMAN
STATE AND LOCAL TAX FORUM
VANDERBILT UNIVERSITY LAW SCHOOL

Legislative Background

- Prior to the Tax Cuts and Jobs Act (P.L. 115-97) (“TCJA”), the IRC allowed individuals to claim a deduction for state and local taxes (if itemizing).
- In 2017, the TCJA added section 164(b)(6), limiting the state and local tax deduction for individuals to not more than $10k annually, ($5k, if married filing separately) for taxable years 2018 through 2025.
  - State and local taxes are not deductible when computing the Alternative Minimum Tax.

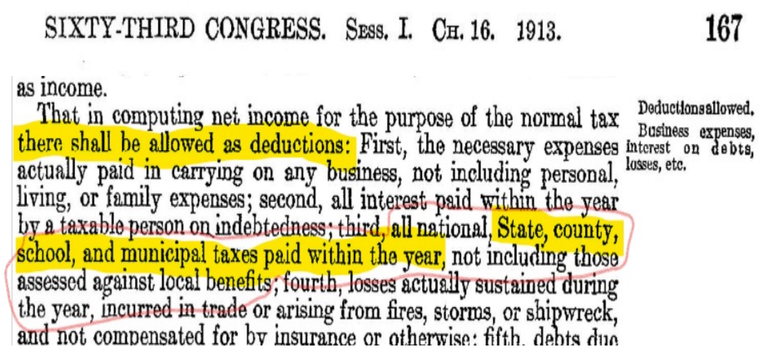

THIRTY-SEVENTH CONGRESS. Sess. I. Ch. 45. 1861. 309

centum. The tax herein provided shall be assessed upon the annual income of the persons hereinafter named for the year next preceding the time for assessing said tax, to wit, the year next preceding the first of January, eighteen hundred and sixty-two; and the said taxes, when so assessed and made public, shall become a lien on the property or other sources of said income for the amount of the same, with the interest and other expenses of collection until paid: *Provided*, That, in estimating said income, all national, state, or local taxes assessed upon the property, from which the income is derived, shall be first deducted.

Of what date to be assessed.
Lien.
Income, how to be estimated.

Sec. 50. *And be it further enacted*, That it shall be the duty of the President of the United States, and he is hereby authorized, by and with the advice and consent of the Senate, to appoint one principal assessor

Mode of assessing and collecting income tax.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as income.

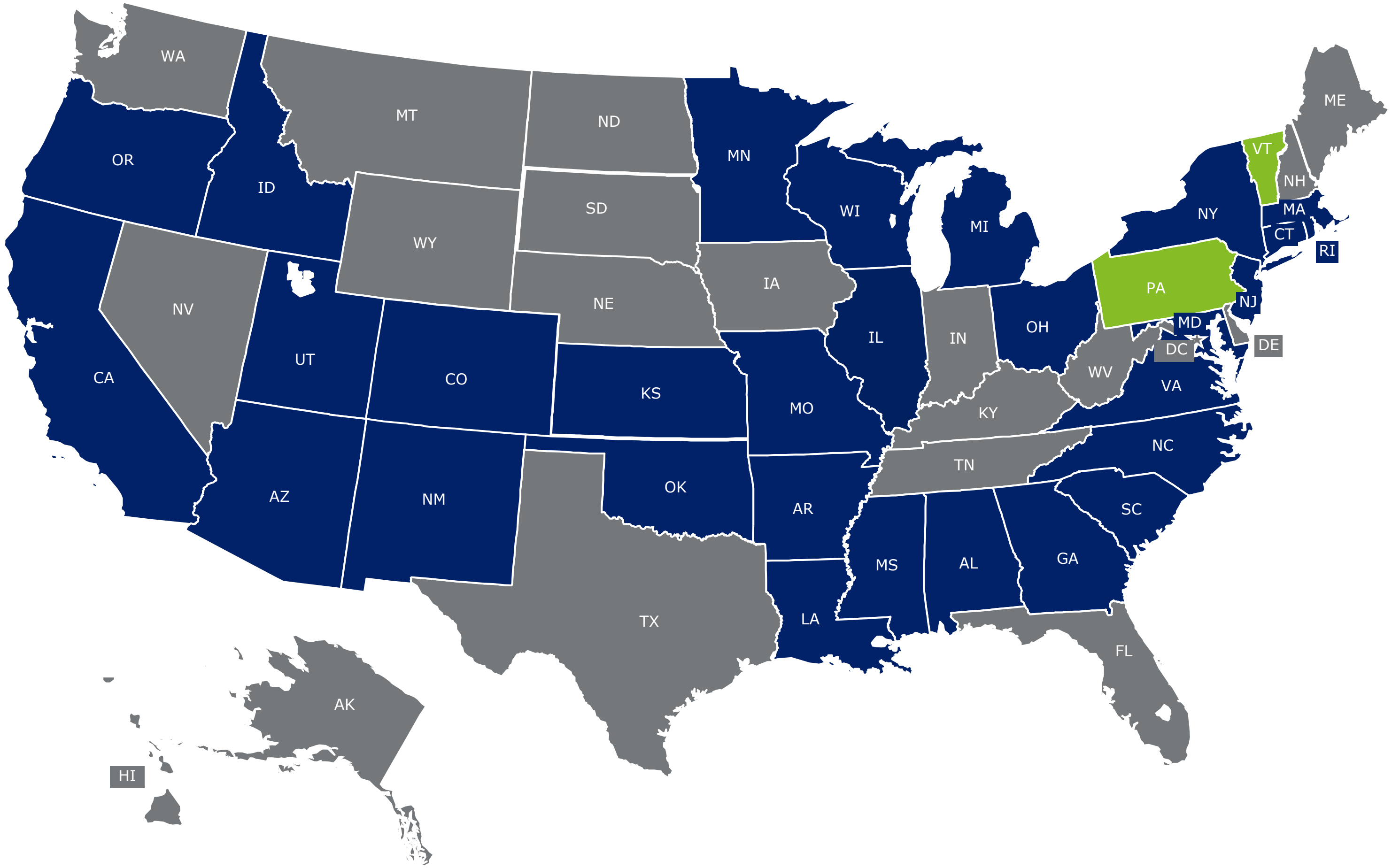
That in computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses; second, all interest paid within the year by a taxable person on indebtedness; third, all national, State, county, school, and municipal taxes paid within the year, not including those assessed against local benefits; fourth, losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; fifth, debts due

Deductions allowed.
Business expenses, interest on debts, losses, etc.

Pass-through Entity Taxes – as of August 15, 2022

Enacted PET legislation

PET legislation pending



*Some jurisdictions such as DC, NH, NYC, TN, and TX impose an income tax directly on pass-through entities.

Polling Question #1

- Among your clients (or yourself), what is the maximum number of states in which you know a single PTE has elected to be subject to a state's elective PTE tax?
  A. None
  B. One
  C. Two
  D. Three
  E. More than three

Notable 2022 State PTE Tax Developments

Notable 2022 PTE Developments

- **Colorado**
  - In May 2022, makes PTE tax (enacted in 2021), retroactive to Jan. 1, 2018. (2022 CO SB 22-124)
    - To make retroactive election, amended composite returns must be filed after Sept. 1, 2023 but before July 1, 2024.
    - Converts income exclusion to refundable credit for PTE owners.
    - Clarifies eligibility of residents for "other state tax credit" for share of PTE taxes paid to other states.
    - ***QUERY***: What will the IRS think about retroactive PTE taxes?

Notable 2022 PTE Developments

- **California**
  - Enacted in Feb. 2022, new law (2022 Cal. Stat. ch. 3 (2022 CA SB 113)), modifies California's PTE tax law
    - Signed by Governor on Feb. 9, 2022 (only six days after introduction into Legislature (must be some kind of record!))
  - Corrects limitations identified by California FTB on PTE election eligibility
    - Corrects technical provision which would not allow PTE tax to be deductible in computing California tentative minimum tax
    - Allows partnerships to be an eligible partner, shareholder or member of a PTE eligible to make the PTE tax election
      - Previously, a PTE could not make an election if a partnership was an owner
    - Allows LLC treated as DRE to be a member (subject to certain conditions)
    - Includes guaranteed payments as qualified income eligible for PTE tax
    - **Requires elective tax credit to be applied against net tax after credits for taxes paid to other states** (See next slide)

Notable 2022 PTE Developments

- **California**
  - On Sept. 28, 2022, Governor Newsom signed legislation (2022 CA SB 851 (as amended in the Assembly Aug. 25, 2022)) that corrects a problem faced by California resident PTE owners with income subject to PTE taxes in other states.
    - CalCPA, AICPA and CA FTB pointed out the benefit of the California PTE tax for resident PTE owners was limited due to a glitch in the way the California “other state tax credit” (OSTC) is computed even after enactment of 2022 AB 113 (described above)
  - New law simply *increases* the “net tax payable” used to compute the OSTC by the amount of PTE tax credit that reduced the net tax in that taxable year.
    - Fixes the “fix”

Notable 2022 PTE Developments

- **New York City**
  - Enacts NYC PTE tax in April 2022 (2022 N.Y. Laws ch. 59, Part MM)
  - In August 2022, advances start date retroactive to Jan. 1, 2022 (2022 N.Y. Laws ch. 555, §14).
    - 2022 PTE election must be made by March 15, 2023
    - PTE must first elect the NYS PTE tax to be eligible for NYC PTE tax
- **Ohio**
  - Enacts elective PTE tax in June 2022 (2022 Ohio SB. 245) (retroactive to 2022 tax year.)

Notable 2022 PTE Developments

- **New Jersey**
  - On Jan. 18, 2022, new law (NJ P.L. 2021, c. 419) significantly modified NJ's PTE Tax (the "Business Alternative Income Tax" (BAIT))
    - For partnerships, expands tax-base to 100% of the distributive share of income of NJ residents and NJ-source distributive share for nonresidents
      - S corporations still limited to NJ-sourced aggregate distributive shares of residents and non-residents (presumably to satisfy FEDERAL S corporation "single class of stock" rules
    - Reduces 10.9% top bracket from $5m of each member's distributive proceeds to $1m
    - Allows PTE that overpays BAIT to carryforward any excess as a credit against following year BAIT liability
    - Clarifies BAIT credits among different types of partners (e.g., individuals, corporations, S corporations)
    - Eliminates 20-year carryforward limitation
    - Partnerships not required to remit nonresident withholding for a nonresident that expects to receive a full refund of such payments due to that taxpayer's share of BAIT payments

Notable 2022 PTE Developments

- **Mississippi**
  - Miss. Dept. of Rev. currently believes that any credit allocated to a partner or member that can't be utilized at the individual level in a given year is lost.
    - No refund or carryover.
    - Beware of this limitation in event of making a PTE election in Mississippi

State PTE Tax Articles

- Steven N.J. Wlodychak, State PTE Tax Updates: Agency Guidance and Even More Differences!, *Tax Notes State*, Feb. 14, 2022, p. 693.
- Steven N.J. Wlodychak, "They're All Different and That's the Problem: State PTEs," *Tax Notes State*, Aug. 2, 2021, p. 455.
- Steven N.J. Wlodychak, "I Told You So: Maine Denies Resident Credit for Other State's PTE Tax," *Tax Notes State*, Nov. 8, 2021, p. 613.
- Steven N.J. Wlodychak, "IRS Just Raised State Taxes for Multistate Passthrough Entity Owners," *Tax Notes State*, Dec. 14, 2020, p. 1159.

Timing of Deductions for PETs

Timing of Deductions for PETs

Accrual Method – Deductions

- Deductions generally
  - Ordinary and necessary trade or business expense under IRC section 162
  - All events test under Treas. Reg. § 1.461-1(a)(2)
    - Fact of the liability exists
    - Amount can be determined with reasonable accuracy, and
    - Economic performance has occurred

Timing of Deductions for PETs

Fact of the Liability Established

- The fact of the liability will ordinarily be established when payment is unconditionally due or when required performance occurs on the part of the other party.
- The determination of the fact of a liability must be made on the basis of facts actually known or reasonably knowable as of the close of the tax year.
  - *U.S. v. General Dynamics*, 481 U.S. 239 (1987).
    - Self-insured employee medical expenses for which the employee files claims are not deductible by the employer until claim is filed.
  - *U.S. v. Hughes Properties*, 476 U.S. 593 (1986).
    - The remote and speculative possibility that the casino's jackpot might never be won did not change the fact that the last play of each progressive slot machine fixed the taxpayer's liability to pay the progressive jackpot amount.

Timing of Deductions for PETs

Reasonable Accuracy

- Liability will be determinable with reasonable accuracy when the basis for the calculation is known or knowable.
- Focus is on whether the facts on which the calculation will be based are established as of the end of the year.
- Correction of an estimate
  - If a liability is properly taken into account based on a computation made with reasonable accuracy and the exact amount of the liability is determined in a later tax year, the difference is accounted for in the later year.
  - Treas. Reg. § 1.461-1(a)(3)

Timing of Deductions for PETs

Section 461(h) – Economic Performance

- A taxpayer incurring an obligation for an item of expense will not be entitled to a deduction until economic performance has occurred with respect to that item.

Rules are laid out by category of liability
(see common type of liabilities below)

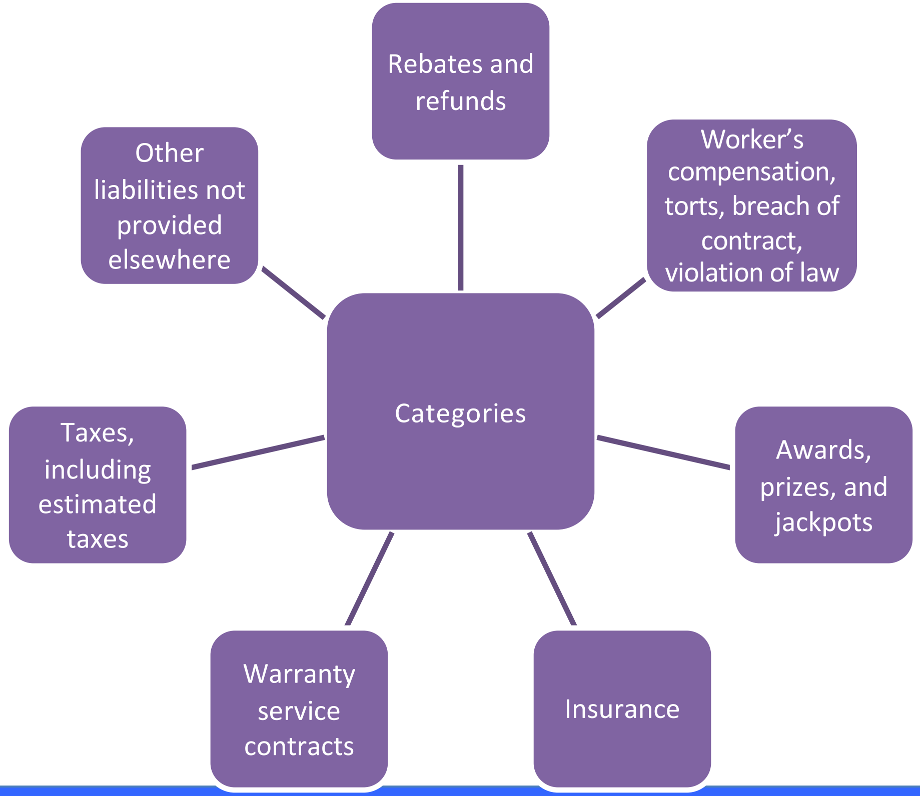
Goods and services provided to the taxpayer	Goods and services provided by the taxpayer	Use of property provided to the taxpayer	Payment liabilities	Interest expense

- Recurring item exception to economic performance

Timing of Deductions for PETs

Payment Liabilities

- General Rule – Treas. Reg. § 1.461-4(g): Economic performance occurs as payment is made to the person to which the liability is owed.



Timing of Deductions for PETs

Treas. Reg. § 1.461-5: Recurring Item Exception

- Treas. Reg. § 1.461-1(a)(3) – may adopt the recurring item exception
- Allows the deduction of certain items when economic performance has not been met by year-end.
- **Recurring item exception applies if** –
  - All events test is satisfied as of year-end
  - Economic performance occurs on or before the earlier of
    - The date the taxpayer files a timely (including extensions) return for that tax year or
    - 8 ½ months after year-end
  - Liability is recurring in nature and
  - Liability is either
    - Not material or
    - Results in better matching with related income
      - See Treas. Reg. § 1.461-5(b)(5)(ii) for list of liabilities for which this requirement is deemed satisfied.

Timing of Deductions for PETs

Evaluating the Timing of the Deduction for PETs

- Analysis of the state's PET laws and rules is necessary to determine deductibility for federal income tax purposes, including any procedural guidance for taxpayers to make the PET election.
- For an accrual basis taxpayer, key considerations include:
  - Determining whether the pass-through entity's liability is fixed as of tax year-end;
  - Reviewing the state's payment and election procedures;
  - Determining whether the election was properly effectuated and timely made;
  - Assessing whether the pass-through entity legally bound itself to make the election (e.g., through a board resolution); and
  - Reviewing the potential application of the recurring item exception.

Financial Statement Considerations

Financial Statement Considerations – Accounting for Income Taxes

- ASC 740 guidance on attribution of income taxes to the entity or its owners indicates:
  - A determination must be made about whether, *based on the laws and regulations of each specific jurisdiction*, the taxes paid by the entity are attributable to the owners of the entity.
    - If an income tax assessed on an entity is deemed to be attributable to the entity, then the taxes paid (along with any deferred tax effects) should be accounted for by the entity in accordance with ASC 740.
    - If the tax paid is attributable to the owners, then the taxes paid would be accounted for outside of ASC 740.
  - ASC 740-10-55 contains several illustrative examples in ASC 740-10-55-226 through 55-228, which provide a high-level framework for making this assessment.

Financial Statement Considerations – Accounting for Income Taxes (cont.)

- **<u>Attribution of Income Taxes to the Entity or Its Owners - Examples</u>**
- **ASC 740-10-55-226:** Entity A, a partnership with two partners—Partner 1 and Partner 2—has nexus in Jurisdiction J. Jurisdiction J assesses an income tax on Entity A and allows Partners 1 and 2 to file a tax return and use their pro rata share of Entity A's income tax payment as a credit (that is, payment against the tax liability of the owners). **Because the owners may file a tax return and utilize Entity A's payment as a payment against their personal income tax, the income tax would be attributed to the owners by Jurisdiction J's laws whether or not the owners file an income tax return.** Because the income tax has been attributed to the owners, payments to Jurisdiction J for income taxes should be treated as a transaction with the owners. The result would not change even if there were an agreement between Entity A and its two partners requiring Entity A to reimburse Partners 1 and 2 for any taxes the partners may owe to Jurisdiction J. This is because attribution is based on the laws and regulations of the taxing authority rather than on obligations imposed by agreements between an entity and its owners.

Financial Statement Considerations – Accounting for Income Taxes (cont.)

- **Attribution of Income Taxes to the Entity or Its Owners – Examples (cont.)**

- **ASC 740-10-55-227:** If the fact pattern in paragraph 740-10-55-226 changed such that **Jurisdiction J has no provision for the owners to file tax returns** and **the laws and regulations of Jurisdiction J do not indicate that the payments are made on behalf of Partners 1 and 2**, income taxes are attributed to Entity A on the basis of Jurisdiction J's laws and are accounted for based on the guidance in this Subtopic.

- **ASC 740-10-55-228:** Entity S, an S Corporation, files a tax return in Jurisdiction J. An analysis of the laws and regulations of Jurisdiction J indicates that **Jurisdiction J can hold Entity S and its owners jointly and severally liable for payment of income taxes**. The laws and regulations also indicate that if payment is made by Entity S, **the payments are made on behalf of the owners**. Because the laws and regulations attribute the income tax to the owners regardless of who pays the tax, any payments to Jurisdiction J for income taxes should be treated as a transaction with its owners.

Financial Statement Considerations – Accounting for Income Taxes (cont.)

- Items to consider when determining attribution include (but are not limited) the following:
  - Whether the entity or the owners are entitled to a refund of an overpayment of taxes paid by the entity
  - Whether the entity or the owners are responsible for paying taxes associated with uncertain tax positions
  - Whether payment is mandatory or elective
  - Does the state include a "toll charge" for making the election (e.g., is there a portion of the tax that is not creditable by the owners on their individual state tax returns?)
  - Whether the partnership looks to the characteristics of the owners when determining the amount of tax the entity is required to pay, for example:
    - Whether different amounts of tax are paid on income attributable to resident vs. nonresident owners
    - Whether different amounts are paid on income attributable to individual vs. legal entity owners such as corporations and partnerships
    - Whether owners must individually elect to be included in the entity's election to pay the tax
    - Whether the tax rate(s) used to compute the tax is it more akin to the corporate or to the personal tax rates used in the state

THE MTC'S AMBITIOUS NEW PARTNERSHIP TAX PROJECT

Multistate Tax Commission Project on State Taxation of Partnerships

- Taxation of Partnership Income and Items
  - Nexus
  - Conformity and its implications
  - Sourcing and credits for taxes paid

Multistate Tax Commission Project on State Taxation of Partnerships

- Taxation of Gains/Losses from Sale of Partnership Interest
  - Nexus
  - Conformity/adjustments
  - Sourcing (same as operating income or different?) and credits for taxes paid

Polling Question #2

- How aware are you of the MTC's state partnership taxation project:
  A. Very well aware – I've listened to/participated in a few of the MTC's sessions
  B. I read about it on the MTC's website or in the tax publications
  C. This session will be the first time I have ever heard about it

Multistate Tax Commission Project on State Taxation of Partnerships

- Administrative and Enforcement
  - Information reporting – pass-through taxation
  - Withholding
  - Composite and PTE Taxes
- More details at: https://www.mtc.gov/Uniformity/Project-Teams/Partnership-Tax
- First sub-project: state taxation of "investment partnerships"

MTC Model Act on "Investment Partnerships"

- Issued in draft form in July 2022, based in large part on the *Alabama Investment Partnership Act of 2009* (2009 Ala. Acts ch. 144, §10, (codified at Ala. Code §40-18-24.2 to 24.3)), and designed to address the "trillions of dollars flowing through investment partnerships … [which is] not a very transparent industry…"
- Stated goal is to create a safe harbor for qualified investment partnerships ("QIPs") and their non-resident qualified partners so the partners' distributive shares of income/loss from the QIP are sourced to their respective states of residency or domicile (vs. apportioned)
- Helpful drafters' notes, including this roadmap: "This draft model is designed to impose three independent qualifications for the safe-harbor sourcing. First, the partnership must be a Qualified Investment Partnership. Second, the partner must be a Qualified Investment Partner. Third, the income or loss subject to the sourcing rules must be Qualified Investment Partnership Income (or Loss).
- As with any complicated tax statute, the definitions are the key…

MTC Model Investment Partnership Act

- Certain commentators accused the MTC Partnership Work Group/staff of cherry-picking the most restrictive provisions from the Alabama and certain other state investment partnership statutes and tightening them even further.
- After some discussion, latest draft [as of 8/18/22] defines QIP Partners to include only non-resident individuals and taxable estates and trusts (not corporations or financial institutions)
- The draft model has undergone several iterations, and in our unofficial opinion, is much improved over the initial draft, especially in terms of anti-abuse and self-dealing prohibitions
- Partnership Work Group awaiting promised comments from ABA Tax Section task force before moving on to the next phase

AICPA Comments on MTC Model Act
(submitted 9/12/22)

- Several definitions and application of QIP rules (narrower and more restrictive" than many state investment partnership acts
- Shouldn't automatically exclude all dealers in qualifying investments as qualifying partners
- Don't require QIP to attach detailed list of investments/other investment info (asset values) to state return
- Next step?

APPORTIONMENT OF PASS-THROUGH ENTITY INCOME: GAIN FROM THE SALE OF ENTITY INTERESTS

Gain from the Sale of a PTE Interest General Principles & Deviations

- **Increasing Variation**
  - "*Mobilia sequuntur personam*," generally taxed to state of domicile
  - Some states have specific rules for nonresident PTE owners
    - Corporate – States Vary:
      - Unitary – Apportionable business Income
      - Non-Unitary – Allocable nonbusiness income
- **Outlier – Ohio**
  - According to R.C. 5747.212:
    - Taxpayer owning 20% or more of a PTE
    - At any point in preceding 3 years
    - Must apportion capital gain from the sale of PTE interest to Ohio
    - Using the entity's average apportionment factors for the preceding 3 years

Gain from the Sale of a PTE Interest – Mass.

VAS Holdings & Investments LLC v. Comm. of Rev., Mass. S. Jud. Ct. No. SJC-13139 (May 16, 2022)

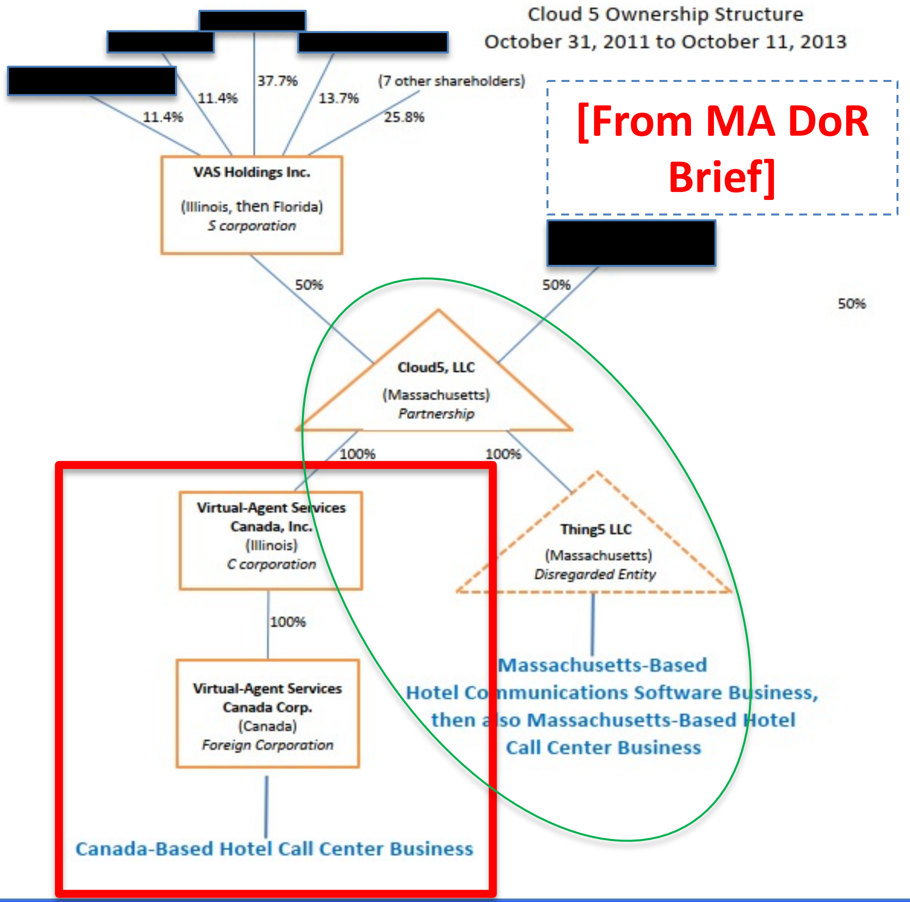
- **Holdings**:
  - Court rejects taxpayer's constitutional argument that a unitary relationship is required to impose tax on the gain from the sale of a partnership interest by nonresident taxpayers
  - But still finds for the taxpayers because the regulation was not consistent with the statute:
    - Massachusetts statute situsing S corporation income required that it must have a unitary relationship with the partnership in order to impose tax on the gain from the sale of the partnership interest.
    - Finds Massachusetts Department of Revenue (MA DOR) regulation imposing a "winner-take-all" allocation provision based solely on the payroll and property factors was not consistent with the statute.
- **Relevant Law**:
  - 830 CMR 63.38.1(9)(d)3.e required an S corporation to apportion gain from the sale of an interest in a partnership to Massachusetts if "the sum of the partnership's Massachusetts property and payroll factors for the taxable year in which the sale occurred exceeds the sum of its property and payroll factors for any other one state."
    - Regulation promulgated in 1995 and "interprets" Mass. corporate tax statute under Mass. Gen. Laws ch. 63, sec. 38
    - Promulgated in 1995 while the MA DOR litigated a similar issue **which it lost** in *Comm. of Rev. v. Dupee*, 670 N.E.2d 173 (Mass. 1996)

Gain from the Sale of a PTE Interest – Mass.

VAS Holdings & Investments LLC v. Comm. of Rev. (cont.)

Facts:

- VAS Holdings & Investments, Inc. (VASHI), was an Illinois S corporation that reincorporated to Florida and essentially operated as a holding company
  - VASHI's only asset was a 50% membership interest in Cloud 5, LLC (Cloud 5), an operating Massachusetts LLC (taxed as a partnership).
- Nearly all of the LLC's U.S. property and payroll were in Massachusetts
  - Both MA DOR and Massachusetts Appellate Tax Board (MA ATB) disregarded substantial Canadian operations in a C corporation all of the stock of which was VASHI's contribution of assets to create Cloud5.
- MA DOR concedes that VASHI and Cloud 5 were not "unitary" under 3-factor test (i.e., no centralized management, economies of scale, or functional integration)
- VASHI sells its 50% membership interest and realizes a gain of $37 million.



Gain from the Sale of a PTE Interest – Mass.

VAS Holdings & Investments LLC v. Comm. of Rev. (cont.)

- **Arguments:**
  - Taxpayer argues Massachusetts is constitutionally prohibited from imposing tax on the gain from the sale of the LLC interest where the S corp. and LLC are not unitary
    - *See, Allied-Signal, Inc. v. Director, N.J. Div. of Tax.* (U.S. S.Ct. 1992) and *MeadWestvaco Corp. v. Ill. Dept. of Rev.* (U.S. S.Ct. 2008) ("*MWV*").
  - MA DOR relies on its regulation designed as an "investee apportionment" rule, and therefore a unitary relationship was not required
    - Citing *Allied-Signal, Inc. v. Commissioner of Finance*, 79 N.Y.2d 73 (1991) (decided ***BEFORE*** the U.S. Supreme Court rulings in *Allied-Signal* and *MWV*), and *International Harvester Co. v. Wisc. Dept. of Tax.* (1944).
- **MA ATB Holding:**
  - Based on the MA DOR regulation upholds apportioning 100% of the gain to MA, disregarding the taxpayer's constitutional arguments entirely
  - S corp's gain was "inextricably connected to and in large measure derived from property and business activities in Massachusetts" conducted by the LLC, citing another case.

Gain from the Sale of a PTE Interest – Mass.

- ***VAS Holdings & Investments LLC v. Comm. of Rev.*** **(cont.)**
- **Massachusetts Supreme Judicial Court:**
  - ***Constitutionality*** **(Is this just dicta?)**
    - Unitary relationship between taxpayer and investee is one justification for apportionment but not the only one.
    - Cloud 5 is domiciled and headquartered in the Commonwealth and its growth is attributable to the benefits, opportunities, and privileges afforded to it by the Commonwealth.
    - Use of Cloud 5's apportionment percentage satisfies the constitutional requirement that there be a rational relationship between the tax and the activities of the entity that is the source of the value.
  - ***Statutory Limitation: Corporate Tax - S Corp Excise***
    - Apportionable income is narrowly defined by the STATUTE by reference to the unitary business principle.
    - Allocable income is an item of income that was not derived from a unitary business or from transactions that serve an operational function.
    - Allocable items are not allocated to Massachusetts if the taxpayer's commercial domicile is outside the Commonwealth.
    - **Statutory Limitation**: Individual Tax - Composite Tax
    - Taxation of nonresidents on income derived from or effectively connected with . . . any trade or business . . . carried on by the taxpayer in the Commonwealth.
    - **VASHI did not conduct a trade or business –** reverses MA ATB and finds for taxpayer.

Gain from the Sale of a PTE Interest – New York City

***[TAXPAYER] v. N.Y.C. Tax Appeals Tribunal*,** Appeal No. 15710 Index No. TAT (E) 16-9 (GC)M-M-640 Case No. 2021-02517 (April 12,2022)

Case Overview:

- Master Fund sold a minority interest (~10%) in [Asset Management] LLC ("Asset Management LLC") at a gain
- Holdings Corp ("FOH Corp") owned 89% of the Master Fund
- All investment management activities for Asset Management LLC were conducted 100% from London while Asset Management LLC operated 100% within NYC
- Master Fund and Holdings Corp had no employees, property or connection to NYC except for the limited partner interest in Asset Management LLC
- In 2010 when Master Fund sold its interest in Asset Management LLC, Holdings Corp followed a non-unitary approach and used separate accounting to include only the operating income from Asset Management LLC as NYC sourced. None of the capital gain from the sale was sourced as NYC income.

Gain from the Sale of a PTE Interest – New York City

NYC Tax Appeals Tribunal opinion

NYC challenged the approach on audit and took the position in several administrative law decisions that

- the "nonexistence of unitary business" between Holdings Corp, Master Fund and Asset Management LLC was "irrelevant" and
- the capital gain should have been apportioned to NYC by Holdings Corp using the Business Allocation Percentage ("BAP") of Asset Management LLC, rather than the location of Holdings Corp or the investment manager.

- Holdings Corp filed petitions that brought the case through the NY Tax Appeals Tribunal and finally to the NYS Appellate Division, which affirmed the prior decisions
  - Taxpayer declined to further appeal the decision

Gain from the Sale of a PTE Interest – New York City

Impact of the case?

- Result raises questions about how and when is reasonable for NYC to apply discretionary authority
  - Within this case they are applying arguments to change BAP and business income base interchangeably.
  - They are also applying "investee" apportionment which was limited in NY statute for allocation of Investment Capital
- Corporate reporting post-reform
  - Post-2015 statute includes net gains from sales of partnership interests in the apportionable business income base but not in the sales factor*
    - *unless commissioner exercises discretion
  - Draft apportionment regs released July 1 include an example related to the net gain from a sale of a partnership interest that makes up 75% of a corporate partner's business receipts for a year.
    - This example suggests that NY would apply discretion and would source the gain to NY based on the value of gain attributable to the underlying partnership's assets as follows:
      - » Real & tangible property if located in NY
      - » Goodwill if "value accumulated in NYS, based on the partnership's average BAP from previous years"

State Treatment of Gain from Sale of PTE Interests - Utah

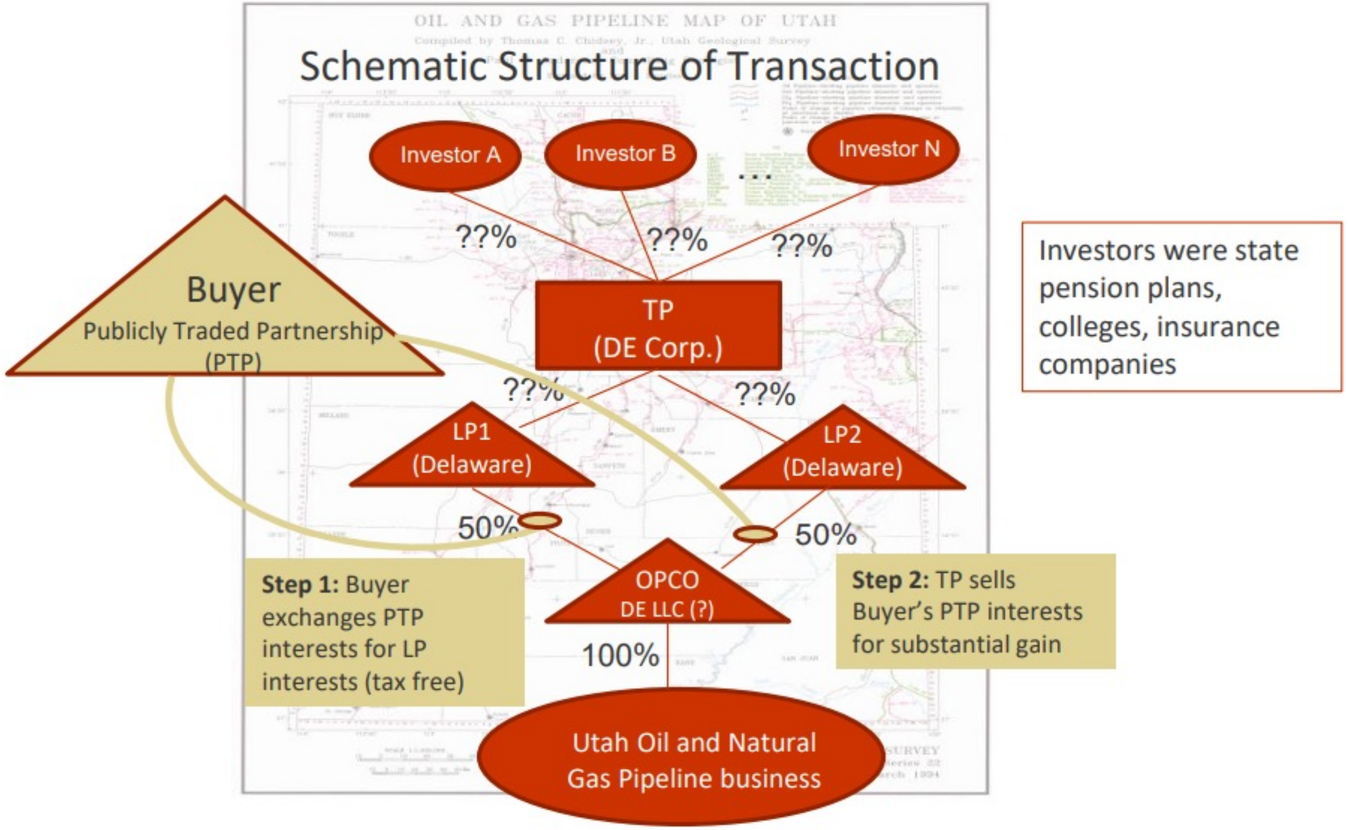
[__________] v. Auditing Div., Utah State Tax Comm., App. No. 16-1358 Order for Summary Judgment (Utah State Tax Comm. Jan. 27, 2022) (unpublished)

Utah State Tax Commission Holding:

- Without a showing that a corporate partner had a unitary relationship with a partnership, under *MeadWestvaco*, "the gain [on the sale of partnership interests by a corporate partner] cannot constitutionally be taxed by Utah."
  - Seems like a completely, 180 degree, diametrically opposed Constitutional finding to *VASHI* in Massachusetts

State Treatment of Gain from Sale of PTE Interests - Utah

[__________] v. Auditing Div., Utah State Tax Comm. (con't.)



State Treatment of Gain from Sale of PTE Interests - Utah

[__________] v. Auditing Div., Utah State Tax Comm. (con't.)

- **<u>Commission Holding</u>**:
  - – Business income determined based on "transactional test" or "functional test" – only one of the two tests must be met.
  - – Gain in this case is "business income" under the functional test
    - TP'S business was to purchase OPCO partnership interests
  - – Exchange of OPCO interests for Buyer PTP interests is a separate transaction from sale of PTP interests
  - – As in *MeadWestvaco*, the asset sold in this case is another business unrelated to the unitary business conducted in Utah. Without a unitary relationship, the gain can't be taxed by Utah.

State Treatment of Gain from Sale of PTE Interests - Michigan

Vectren Infrastructure Services Corp. v. Dept. of Treas., No. 345462 (Mich. Ct. App. March 12, 2020) (on appeal)

- **Issue**:
  – Are Minnesota nonresident taxpayers and owners of S Corporation eligible for alternative apportionment from the sale of a family-owned business which just happened to have a significant Michigan single sales factor for the short-period, three-month return that included the capital gain due to a large, one-off project in Michigan at the time of the sale.

State Treatment of Gain from Sale of PTE Interests - Michigan

Vectren Infrastructure Services Corp. v. Dept. of Treas. (con't)
Mich. Court of Appeals Ruling:

- On appeal, Mich. Ct. App. invokes alternative apportionment under dormant Commerce Clause to source gain from sale of out-of-state S corporation business to headquarters state (not Michigan)
  - "to apply the statutory formula … to the circumstances of this case would result in an imposition of a tax in violation of the Commerce Clause."
  - *Container Corp.* (1983) – U.S. Supreme Court – an apportionment formula must fairly attribute income to in-state activities
  - *Hans Rees* (1931) – taxpayer must present "clear and cogent evidence" of distortion
  - Stock (deemed asset) sale "never had any connection to Michigan. The problem is compounded when the sale occurs in a time period (the Short Year) in which an unusually large percentage of the business activity occurred in Michigan."

State Treatment of Gain from Sale of PTE Interests - Michigan

Vectren Infrastructure Services Corp. v. Dept. of Treas. (con't)
Mich. Ct. of Appeals Ruling (con't.)

- "...[Michigan] apportionment formula is unconstitutional **<u>as applied to [the TP]</u>** under the circumstances of this case
  - Statutory apportionment presumed to be fair
  - To rebut the presumption, the taxpayer must show by "clear and cogent evidence" that
    1. The business activity attributed to the taxpayer is out of all proportion to the actual business activity transacted in this state and leads to a grossly distorted result, **<u>or</u>**
    2. The apportionment formula would operate unconstitutionally to tax the extraterritorial activity of the taxpayer, citing *Trinova v. Dep't of Treas.*, 433 Mich. 141 (1989), *aff'd* 498 U.S. 358 (1991)

State Treatment of Gain from Sale of PTE Interests - Michigan

Vectren Infrastructure Services Corp. v. Dept. of Treas. (con't)

Mich. Ct. of Appeals Ruling (con't.)

- Remands to Mich. Ct. of Claims to determine reasonable apportionment formula
- Michigan Department of Treasury (MI DOT), however, appeals to Mich. S. Ct. (Sept. 30, 2021)(Case # 163742)
  - MI DOT claims only it has authority to determine alternative apportionment method, despite the statutory language

State Treatment of Gain from Sale of PTE Interests - Michigan

Vectren Infrastructure Services Corp. v. Dept. of Treas. (con't)

Mich. Supreme Court

- On Mar. 23, 2022, Mich. S. Ct does something unusual:
  - Instead of granting or denying the MI DOT application for leave to appeal, the Court orders the filing of supplemental briefs, followed by oral argument, asking the parties to address three issues, the most notable being:
    - "(2) whether application of the statutory formula in this case runs afoul of the Due Process and Commerce Clauses … because it does not fairly determine the portion of income from the sale of a business attributed to in-state activities…"
- Briefs have been filed, parties awaiting date for oral argument

California FTB Opens the Door to Investee Apportionment?

California

- Cal. FTB Legal Ruling 2022-02 (July 14, 2022)
  - On July 14, 2022, California FTB released Legal Ruling regarding the sourcing of the IRC §751(a) gain from the disposition of a nonresident individual's partnership interest when the IRC §751 property is located in California
  - The FTB concluded that the gain/loss associated with the partnership's IRC §751 property is sourced to California
  - The deemed sale of the IRC §751 property is not treated as a sale of intangible property and is not treated as an asset sale by the transferor partnership. It is treated as income from a "trade or business" (FTB Reg. 17951-4).

California FTB Opens the Door to Investee Apportionment?

California

- Cal. FTB Legal Ruling 2022-02 (July 14, 2022) (cont.)
  - Narrow ruling (hopefully!) on situsing of gain on sale of partnership interest by nonresident partner relating to partnership's unrealized receivables or inventory under IRC §751
    - IRC §741 generally treats sale of partnership interest as a sale of the interests themselves (i.e., sale of intangible property)
      - Federal "entity" theory exception to "aggregate" theory of taxing partnerships
      - For state purposes, situs to state of residence of partner
    - IRC §751 – "hot assets" exception – treats partnership gain relating to unrealized receivables and inventory of the partnership as partnership gain (intended for federal purposes to prevent reclassification of gain from ordinary to capital)
      - For state purposes, situs to location of the business activity relating to those assets (i.e., apportioned or allocated – disregard residence of partner)

NYS Draft Corporate Tax Rules Contain Detailed Rules on Corporate Partners

- The New York State Department of Taxation has issued thousands of pages of long anticipated draft regulations in response to the state's corporate tax reform in 2015, primarily designed to establish mandatory combined reporting
- Parts 1-3 (about 150 pages) address nexus, accounting methods, tax bases, income determinations
  - Initial draft in April 2021, Final April 2022
  - Revised draft in August 2022
- "Easter eggs" included detailed, comprehensive draft regulations on the treatment of foreign corporate partners
  - (Draft codified at Sec. 1-2.3)

NYS Draft Corporate Tax Rules Contain Detailed Rules on Corporate Partners

- **Highlights**
  - Corporation that hold partnership interests are subject to New York corporate tax if they are:
    - **General partners** of partnerships doing business in New York
    - **Limited partners** of partnerships (other than a "portfolio investment partnership") and are "… engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership."
      - This last clause is further specifically defined to includes owning 1% or more interest as a limited partner in the partnership and/or the basis is more than $1 million

NYS Draft Corporate Tax Rules Contain Detailed Rules on Corporate Partners

- **Highlights**
  - "Engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership" is defined over 6 pages of text including:
    - Owning a 1% or more interest as a limited partner in the partnership and/or the basis is more than $1 million (measured by including the ownership interests of corporate affiliated group members, officers or directors of the corporation (or its affiliated group)
    - Any officer, employee or director of the corporation is a general partner of the partnership
    - The corporation owns 5% or more of another corporation that is a general partner of the partnership
    - Officers, employees, directors or agents of the corporation negotiate the terms of the partnership agreement
    - "Substantial communication" between one or more officers, employees, directors or agents of the corporation and the general partner of the partnership regarding the business activities or affairs of the partnership
    - Payment guarantees of loans to the partnership
    - Sales to or from the partnership and the corporate limited partner
    - "Inter-entity" relationships (e.g., common management, common use of assets, common use of facilities, equipment and employees)
  - Corporate members of LLCs treated as partnerships are subject to tax unless the operating agreement imposes limitations on the foreign corporate member's participation in the LLC's management

NYS Draft Corporate Tax Rules Contain Detailed Rules on Corporate Partners

- **Highlights**
  - Bright-line $1 million nexus (Sec. 1-2.8) attributed to:
    - **General partners** – if its receipts combined with those of the partnership total at least $1 million.
    - **Limited partners** – same, if the limited partner is “engaged, directly or indirectly, in the participation in or domination or control of all or any portion of the business activities of the partnership”
    - **LLC members** – same, unless the LLC operating agreement imposes limitations on the corporate member’s participation in the management of the LLC.
      - Less stringent requirements for corporate partners in “portfolio investment partnerships”

NYS Draft Corporate Tax Rules Contain Detailed Rules on Corporate Partners

- **Highlights**
  - One surprise in the August 2022 draft was the inclusion of **Example 16** (Subpart 3-6) which seemingly attempts to codify "investee apportionment" for corporate partners as a result of the New York City Tax Appeals Tribunal decision (discussed earlier)

Example 16

InvestCo is a foreign corporation that owns a minority interest in Asset Manager, a partnership operating solely in New York State that performs a variety of investment activities. InvestCo and Asset Manager are not engaged in a unitary business. Aside from its investment in Asset Manager, InvestCo has no physical presence or activities in New York State.

In 2022 InvestCo sells its interest in Asset Manager for a gain. Because the increase in Asset Manager's value was a result of its activities within New York State and the benefits provided by New York State, InvestCo's interest in Asset Manager is not constitutionally protected investment capital. As such, the interest in Asset Manager is business capital and the gain from disposition of such interest is business income.

Polling Question #3

- In your opinion, should gain on the sale of PTE interests by INDIVIDUALS (including partnership interests, LLC membership interests and shares of S corporation stock) be sourced based on:
  A. State of residence of individual owner (i.e., just like corporate stock)
  B. Apportionment of the PTE in the year of the sale
  C. Some kind of blended apportionment of the PTE reflecting the historic apportionment of the PTE business
  D. Wow … that's really hard to decide. I don't know.

MISCELLANEOUS

Recent Changes to Partnership Audit Rules and the States' Response

Partnership Audit Rules – Background

- **The Bipartisan Budget Act of 2015 Adopted New IRS Audit Procedures for "Large" Partnerships (including Multi-Member LLCs)**
  - Consolidated Appropriations Act of 2018, HR 1625 (P.L. 115-141), enacted in March 2018, made several useful technical corrections and added a unique new "pull-in procedure" described later in these slides
- The new audit rules became effective for taxable years beginning after December 31, 2017
- **Expected to raise additional $9.3 billion in tax revenue by enabling the IRS to more efficiently audit "large" partnerships and LLCs**
  - According to Government Accountability Office (GAO), less than one percent of large partnerships were audited during 2012, compared to a 27 percent audit rate of corporations with assets exceeding $100 million
  - IRS reported to be "ramping up" partnership audits and completed intensive training of the first group of auditors to handle these audits

New Federal Partnership Audit Rules: State Implications

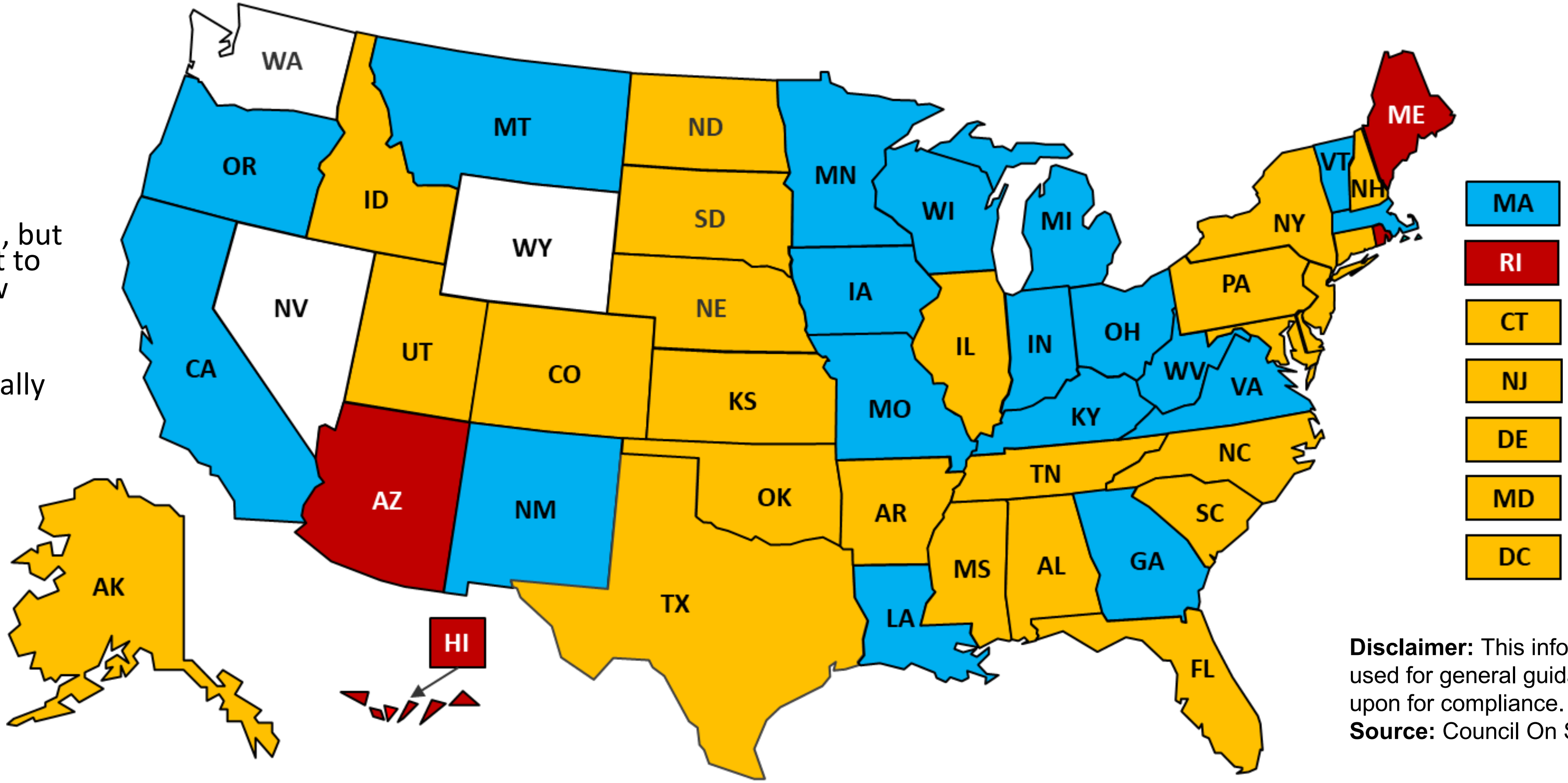
- **MTC worked with the "Interested Parties" to develop a model statute**
  - American Institute of CPAs (AICPA)
  - Council On State Taxation (COST)
  - ABA Section of Taxation SALT Committee Task Force (ABA)
  - Tax Executives Institute (TEI)
  - Institute for Professionals in Taxation (IPT)
  - Master Limited Partnership Association (MLPA)
- Model can be found at: http://www.mtc.gov/Uniformity/Project-Teams/Partnership-Informational-Project (excellent research source)

Comparison of Federal Process to MTC Model Statute

Federal Audit Reporting Process	MTC State Model Process
Default – Partnership pays the tax using highest individual/corporate income tax rates	Default – Partnership notifies partners and partners pay the tax (composite/withholding filers still subject to partnership paying the tax)
Has option for partners to file amended returns (or simply pay ("pull-in")) to remit tax	Such partners required to report under the general reporting requirements at the state level (*i.e.*, file separate amended state return). Those partners are <u>not</u> be included in any partnership pays tax calculation.
Has option for partnership to "push-out" tax to review year partners to remit the tax when they file their tax return for the year IRS completes the audit (adjustment year)	"Push-out" option requires reporting and payment on an amended return for original ("reviewed") year. Ability to report/pay tax on current year tax return unavailable (likely an administrative systems issue w/most states)
Tiered Partners – must complete all filings by the extended due date of the Audited Partnership's return for the adjustment year	Subject to extension, Tiered Partners must complete all reporting and payments 90 days after the extended due date of the Audited Partnership's return for the adjustment year

States That Need to Enact Legislation to Adopt the MTC Model, or Need Improvements to More Closely Follow the MTC Model

- States that have enacted legislation
- States that have enacted legislation, but need improvement to more closely follow MTC Model
- States that potentially need legislation



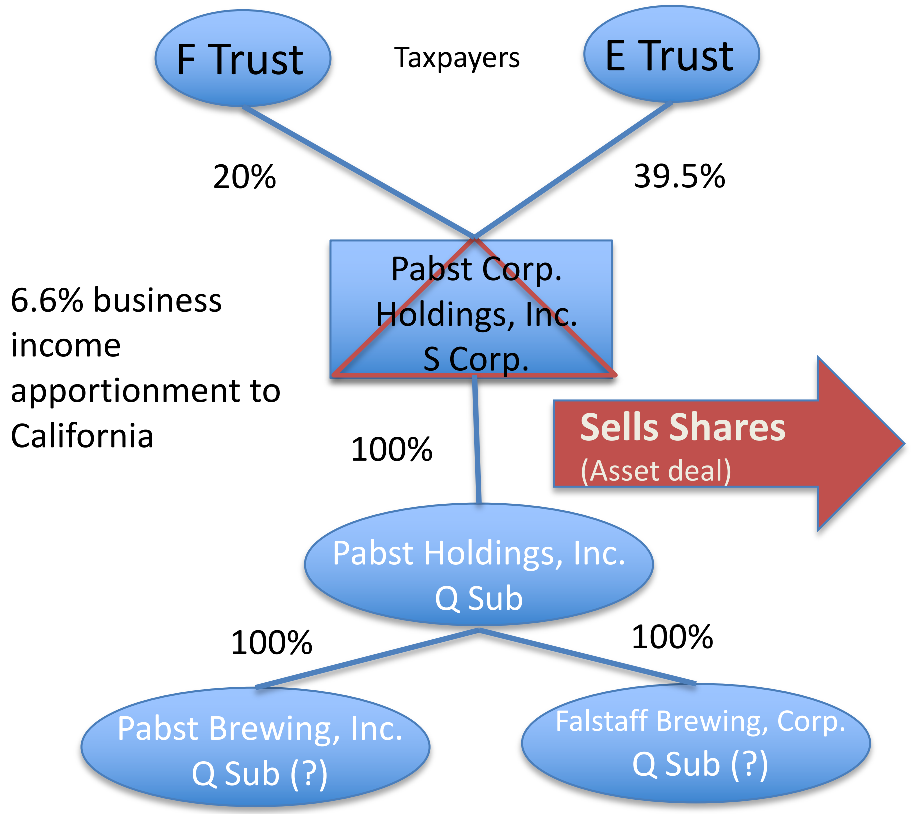
Disclaimer: This information should be used for general guidance and not relied upon for compliance.
Source: Council On State Taxation

Polling Question #4

- How many clients are you aware of that have been subject to a **FEDERAL** partnership audit under the new BBA rules?
  A. None
  B. One
  C. Two to ten
  D. Eleven or more

California – Sourcing of Goodwill Gain for Trust owning S corporation

- **California**
  - *[TAXPAYER] v. California Franchise Tax Board,* No. S275377 *pet. den.* (Cal. S.Ct. Aug. 24, 2022) (opinion below: *J.P. Morgan Trust Co. of Delaware v. Franchise Tax Bd*., 79 Cal. App. 5th 245, 294 Cal. Rptr. 3d 557 (Cal. 4th App. Dist., May 27, 2022)
    - Despite numerous practitioner requests, the California Supreme Court refused to hear an appeal of lower court rulings requiring the apportionment of gain on sale of goodwill of S corporation by nonresident trusts (also Court did not agree to "depublish" opinion)



California – Sourcing of Goodwill Gain for Trust owning S corporation

- **California**
  - *[TAXPAYER] v. California Franchise Tax Board*, Cal. No. S275377 *rev. den.* (Cal. S.Ct. Aug. 24, 2022) (opinion below: *J.P. Morgan Trust Co. of Delaware v. Franchise Tax Bd*., 79 Cal. App. 5th 245, 294 Cal. Rptr. 3d 557 (Cal. 4th App. Dist., May 27, 2022)
    - FACTS
      - S corporation sells shares of qualified S corporation subsidiary (Q-Sub) treated as sale of assets
        - » California corporate and personal income tax laws conform to federal election
      - Trust owners originally treat gain as" business income" of S corporation subject to apportionment (6.6%) but file refund claim on grounds that under statute, income of nonresidents from intangibles is not taxable in California by statute
      - Conflict between situsing rules of California personal income tax statute and regulation
        - » Cal. Rev. & Tax Code §17952
          - "Taxable income of a nonresident …" does not include "income of nonresidents from stock, bonds, notes or other intangible property … unless the property has acquired a business situs in [California] …"
        - » Cal. Code Regs. tit. 18, §17951 –4(f)
          - If a nonresident is a shareholder of an S corporation … which carries on a unitary business, trade or profession within and without [California], the amount of the nonresident's pro rata share of S corporation income derived from sources within this state shall be determined in the same manner as if the S corporation were a partnership (i.e., as business income subject to apportionment).
    - HOLDINGS: Cal. OTA and courts effectively hold that FTB Regulation supersedes Statute (?)

Pennsylvania PIT: Finally, "Like-Kind Exchange" Conformity

- **Pennsylvania**
  - Finally, Pennsylvania legislature enacts provision conforming its Personal Income Tax (PIT) law to the tax-free "like-kind exchange" rules under IRC §1031
    - Pa. Act of Jul. 8, 2022 (P.L. 513, No. 53, §4) (codified at 72 P.S. § 7303(a.5)).
  - For description of nonconformity of prior PA PIT law to federal LKE rules, see e.g., Pa. Dept. of Rev., PIT Bull. 2006-07, *Pennsylvania Tax Treatment of IRC § 1031 Like-kind Exchanges*, (Oct. 20, 2006, rev. Dec. 21, 2017)
  - Partnerships and S corporations governed by PIT law
    - PA Corporate Income Tax (CIT) law had long conformed to IRC §1031.
  - ***CAUTION***: PA PIT law still does not conform to important federal provisions (but PA CIT law does)
    - Most notable – IRC §338(h)(10) – "deemed asset" sale elections for S corporations still treated as stock sales for PA PIT purposes.

The Long and Winding Road of Partners "Doing Business" in California

- **California**
  - "Doing business" cases
    - $800 minimum tax
      - Cal. Rev. & Tax. Code §23101
        - » Two alternative tests
          - Historic "qualitative" test
          - Since 2011, "bright-line" test (e.g., greater than $50k "in-state" payroll or property or $500k "in-state" sales?
    - Addresses "nexus" under California STATUTE, not constitutional "nexus"
    - Iterative judicial and administrative analysis over the years
    - LATEST CASE addresses "tiered partnerships"
      - How do property, payroll and sales flow up from underlying partnerships "doing business" in California to upper tier partnerships for purposes of "doing business" statute?

The Long and Winding Road of Partners “Doing Business” in California

- *I/M/O MJK Real Estate Fund II, LLC*, 2022-OTA-247P (May 26, 2022) (pending precedential)
  - QUESTION? What ownership measure is used to determine the “bright-line” “doing business” factors of a pass-through entity that itself owns interests of other pass-through entities that are “doing business” under the California “bright-line” standard:
    a) Profits interest percentage;
    b) Loss interest percentage; OR
    c) Capital interest percentage?

The Long and Winding Road of Partners "Doing Business" in California

- *I/M/O MJK Real Estate Fund II, LLC*
  - Minnesota LLC with no other contacts to California had direct and indirect interests in partnerships owning real estate in San Diego
    - Cal. Rev. & Tax. Code §23101(d) only states that the "sales, property, and payroll of the taxpayer include the taxpayer's pro rata or ***distributive share*** of pass-through entities"
      - Citing to both California statutes and federal income tax law on taxation of partnerships, OTA finds "ambiguity in the [statutory] language" as to which ownership percentage measurement to use.
      - Despite FTB position that the partnership income apportionment regulation was not relevant to nexus, OTA cites to FTB Reg. 25137-1(f)(4) assigning income from partnership to partners for determining a partner's interest in a partnership for "doing business" bright-line test.
        - » Since Jan. 1, 2019, that regulation cites to **"[partner's] interest in profits of the partnership"**
        - » FTB fails to convince OTA that it had previously used "capital interest" – still ambiguous

The Long and Winding Road of Partners "Doing Business" in California

- *I/M/O MJK Real Estate Fund II, LLC*
  - OTA finds that because of the ambiguity, there should be consistency between the standard for assigning partnership income (Cal. Code Regs. tit. 18, 25137-1) and the "doing business" standard for purposes of "nexus" (Cal. Rev. & Tax Code §23101) – supporting use of "**Profits Interest**" (taxpayer position)

Taxpayer	FTB
Profits Interest: 6.9872% X 5.21% (indirect interest) = 0.3640%	**Capital Interest: 52.35% X 5.21% (indirect interest) = 2.7274%**
Partnership property (***original cost***): **$13,000,000**	
$47,343	**$354,567**
Cal. "doing business" property thresholds TY2013 = **$51,816** TY2014 = **$52,956**	

NOTE: Taxpayer's interest in California property were accumulated through a series of partnership interests

The Long and Winding Road of Partners "Doing Business" in California

- *I/M/O MJK Real Estate Fund II, LLC*
  - In TY2015 and TY2016, taxpayer acquired all the interests of an intermediate tiered partnership that owned the partnership doing business in California and thus, that entity became a "disregarded entity" as if taxpayer owned the interests directly.
    - Once factoring in increase in ownership percentage to 100%, using the profits interest, taxpayer's property factor ($677,300) far exceeded the property thresholds for "doing business" in those years (TY2015 = $53,644 and TY16 = $54,771).

The Long and Winding Road of Partners "Doing Business" in California

- Iterative California "doing business" cases
  - **Pre-2011** – Qualitative nexus ONLY
    - *Swart Enterprises, Inc. v. Franchise Tax Bd., 7 Cal. App. 5th 497 (2017)*
      - 0.2% non-managing member interest not enough to "qualitatively" be "doing business"
    - *Wright Capital Holdings, LLC*, 2019-OTA-219P
      - Out of state LLC owning 50% interest in LLC "doing business" in California is itself "doing business" under Cal. Rev. & Tax. Code §23101(a)
    - *Appeal of Jali, LLC*, 2019-OTA-204P
    - Taxpayer had no ability or authority, directly or indirectly, to influence or participate in the management or operation of the partnership – rejects FTB position that 0.2% in Swart Enterprises was a bright line test (LLC was manager-managed LLC and taxpayer held small (less than 6%) interests in LLC.
    - *Appeal of Satview Broadband, Ltd.*, 2018-OTA-121 (nonprecedential)
      - 25% non-managing member interest in LLC not enough to be doing business in California (relying on *Swart Enterprises*).
  - **Post-2011** - "Bright-line" nexus applies, too as an alternative – NOT substitute - for qualitative nexus
    - *GEF Operating Inc.*, 2020-OTA-057P
      - General partner, even though only 1% owner, is "doing business" wherever the partnership is doing business – "bright-line" nexus is an alternative, not a substitute, "doing business" rule
    - *Appeal of Aroya Investment I, LLC*, 2020-OTA-255P
      - Measure "bright-line" doing business by multiplying ownership percentage by share of partnership property "original cost"
        - » 0.7830849% X $64,329,943 (property in California) = $503,758.07 (property threshold was $54,771).

When a DRE isn't – Property Tax

- **Massachusetts**
  - *Brayton Point Energy, LLC v. Board of Assessors of Somerset*, 101 Mass. App. Ct. 466 (July 29, 2022)
    - Virginia LLC that is disregarded from its corporate owner for federal income and Massachusetts corporate excise tax purposes does not qualify as "business corporation" subject to Massachusetts excise tax for purposes of real property tax exemption.
      - LLC owned coal and fuel oil situated in Massachusetts town.
      - LLC's assets were included in its owner's corporate excise tax returns (Mass. imposes both an income tax and asset measure for its corporate excise tax) - $200k of excise tax liability imposed on its assets (though not separately stated from owner)
      - Town imposes property tax of $1.6m, denying application for abatement claim based on assets being subject to asset base of corporate excise tax

When a DRE isn't – Property Tax

- **Massachusetts**
  - *Brayton Point Energy, LLC v. Board of Assessors of Somerset,* 101 Mass. App. Ct. 466 (July 29, 2022)
    - **Holding**:
      - Mass. property tax law (Mass. Gen. Laws ch. 59, §5(16)(2)) provides an exemption from property tax for "… a business corporation subject to [the corporate excise] tax under [Mass. Gen. Laws ch. 63, §39]"
        - » How DREs are treated for purposes of the exemption is "ambiguous"
      - Based on legislative history and changes to corporate excise statute, court concludes that LLCs treated as DREs are not "business corporations" subject to the corporate excise and therefore, **do not qualify for the property tax exemption** for business corporations subject to the corporate excise tax.
        - » Combined reporting statutory amendments intended to close "corporate tax loopholes" interpreting the statute to expand the exemption to DREs "lacks support in legislative history and would be contrary to the legislative intent."
        - » Reading is consistent with Mass. Dept. of Rev., Bulletin 2013-06B, *Local Option Exemptions for Research and Development Companies and Disregarded Limited Liability Companies* (Dec. 2013).

When a DRE isn't – Income Tax Sourcing

- **New York**
  - *Matter of [TAXPAYER] v. New York State Tax Appeals Tribunal*, No. 531667 (N.Y. App. Div., 3rd Dept. Mar. 10, 2022)
    - Sole corporate owner of two LLCs each treated as "disregarded entities", one a registered broker-dealer and the other a registered investment advisor, can't use the special customer-based sourcing rules applicable to broker-dealers for NY apportionment purposes.
      - Federal DRE rules don't necessarily extend to state receipt sourcing rules
      - "Federal tax law has no counterpart to New York's receipt sourcing rules"

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 (but not effective until Jan. 1, 2024).
    - https://public-inspection.federalregister.gov/2022-21020.pdf
  - 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 one year in which to comply. But reporting companies formed on or after the effective date will be required to report the beneficial ownership information at the time of formation or registration.
    - Any change in reported information must be reported to FinCEN within one year after the change.

Thank you!

Questions and Discussion

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