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Update on the State Taxation of Passthrough Entities and Their Owners

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In this installment of From the SALT Minds, Thistle and Ely review developments in the state taxation of passthrough entities as of May 24. This column draws primarily from the Pass-Through Entities Subcommittee report, which was prepared by Thistle and Co-Chair Kelvin Lawrence of BakerHostetler and delivered at the ABA SALT Committee's Executive Committee meeting May 9 in Washington. Additional information comes from a panel discussion the following day by Ely, Steven N. Wlodychak of EY, and Alysse McLoughlin of McDermott Will & Emery. The authors thank these additional sources.

State and local taxation of passthrough entities presents complex issues for their owners, especially when those entities are conducting business in multiple states. This column surveys developments in passthrough entity taxation over the last six months.

I. Entity-Level Taxes

Arizona/California: On February 28 Arizona filed a unique suit against California over the Golden State's controversial $800 limited liability company (LLC) fee. The Arizona Attorney General's Office contends that California cannot tax Arizona businesses for their non-managing investments in LLCs doing business in California. Arizona filed its complaint in the U.S. Supreme Court challenging the California taxes as unconstitutional and violating both the due process and commerce clauses, including all four factors of the *Complete Auto Transit* test. Arizona further contends that the California Franchise Tax Board seizure orders issued against the bank accounts of taxpayers that do not pay this tax violate the Fourth Amendment, because they are issued without a warrant or other judicial involvement and constitute an extraterritorial, unreasonable seizure. The attorney general estimates that California collects more than $10 million each year from Arizona entities via these taxes — hence damaging Arizona with tax revenue losses.

The California Office of the Attorney General filed its dismissive response on May 24. Not unexpectedly, the attorney general argued that the Court lacks jurisdiction over the issue, and even if it does have jurisdiction, it should nonetheless not exercise it because of the availability of "demonstrably effective administrative and judicial remedies for taxpayers" in California. The attorney general makes short shrift of the pending taxpayer class action suit involving the same issue.[1]

Kentucky: H.B. 458 was signed into law by Gov. Matt Bevin (R) on April 9 as Ky. Acts Chapter 196. The new law provides that when an assessment of limited liability entity tax is issued against a passthrough entity, its partners, members, or shareholders shall have the greater of (1) the amount of time provided by the refund statute (generally four years from the date the payment was made) or (2) 180 days from the date the assessment becomes final to file amended returns requesting a refund of tax for the tax year of the assessment and to allow for items of income, deduction, and credit to be properly reported in the returns of the partners, members, or shareholders of the passthrough entity subject to adjustment.

Maryland: On January 17 the Maryland Tax Court issued a statement of the reasons for its November 30, 2018, order granting the comptroller's motion for summary judgment, effectively affirming the assessments for passthrough entity tax against six single-member LLCs. Maryland imposes its income tax on each nonresident passthrough entity having any member that is a nonresident of the state or a nonresident entity. The court found that because each LLC is a nonresident passthrough entity with the same single member that is a nonresident of Maryland, the state has the authority to tax the LLCs' nonresident taxable income allocable to Maryland. The court found that each LLC has a state income tax liability even though it is not obliged to complete a federal return; they do not receive the same tax treatment as their nonresident owner.[2]

Oregon: On May 16 Oregon Gov. Kate Brown (D) signed into law H.B. 3427A, which imposes a controversial corporate activity tax (CAT) on all businesses (including passthrough entities) having a specific amount of property, payroll, or gross receipts/commercial activity in the state — or that are residents or commercially domiciled in Oregon. The tax is expected to raise approximately $1 billion in revenue annually, earmarked for public education. The tax is imposed at $250 plus 0.57 percent of Oregon-source commercial activity over $1 million. However, similar to the Michigan CAT, Oregon taxpayers may deduct 35 percent of their cost of goods sold or labor costs, whichever is greater. There are many other exclusions. The Oregon CAT is effective for tax years beginning after December 31, 2019, and does not repeal the existing corporate income tax.

II. Attempted SALT Cap Workarounds

Arkansas: H.B. 1714 would provide a workaround for passthrough entity owners whose state and local taxes exceed the $10,000 federal deduction cap enacted as part of the Tax Cuts and Jobs Act in December 2017. This proposal mirrors Wisconsin legislation (discussed later) in that it is an elective entity-level tax, but is not an exact duplicate. The bill would allow S corporations to deduct their SALT, just as C corporations are allowed to.

Connecticut: As previously reported, effective for tax years beginning on or after January 1, 2018, Connecticut levies an income tax on partnerships and S corporations doing business in the state. Individual resident and nonresident owners are allowed a corresponding tax credit against their Connecticut income taxes paid at the entity level. This tax was acknowledged as a response to the IRC section 164 limitation on an individual's SALT deduction under the TCJA.[3]

The new law generally relieves nonresident owners from their individual filing requirement when they have no other sources of Connecticut income and the entity has paid the tax on their behalf. Under this amendment, guaranteed payments are not in the entity tax base. Therefore, nonresident partners with

[1] *Arizona v. California*, U.S. No. 22O150 (filed Feb. 28, 2019).

[2] *CNI Technical Services LLC v. Comptroller of Maryland*, Appeal No. 17-IN-00-0743; Appeal No. 17-IN-00-0748 (Jan. 17, 2019), on appeal to Anne Arundel Circuit Court, case No. C-02-CV-19-000418.

[3] Bruce P. Ely, James E. Long Jr., and Emma A. Cummings, "New AICPA White Paper Explores Passthrough Entity Taxes," *State Tax Notes*, Nov. 26, 2018, p. 777.

guaranteed payments are still required to file a Connecticut individual income tax return.

There are no provisions allowing a partnership to file a composite return for partners receiving Connecticut-source income from guaranteed payments. Recent Department of Revenue Services guidance allows passthrough entities to enter into agreements to report and remit the tax for their nonresident partners receiving Connecticut-source guaranteed payments from the passthrough entity for the passthrough entity's tax year 2018. This option does not relieve the partner of its state filing obligation if it had other Connecticut-source income.

Louisiana: On May 23 the Louisiana Senate approved S.B. 223 to allow S corporations and entities taxed as partnerships at the federal level to elect to treat themselves as state C corporations, retroactively effective to January 1, 2019. The bill would in effect allow individual owners to exclude from Louisiana income the net income or losses received from the electing entity, with the election to last until the Louisiana secretary of revenue consents to its termination. Instead of the current corporate income tax rates (ranging from 4 percent to 8 percent), however, passthrough entities that elect state C corporation status would pay tax at 2 percent on the first $25,000 of taxable income, 4 percent on taxable income between $25,000 and $100,000, and 6 percent on taxable income over $100,000. According to its sponsor, Sen. R. L. Bret Allain II (R), the three-tiered rate structure is designed to be revenue neutral.

Michigan: On March 5 Gov. Gretchen Whitmer (D) proposed in her budget a federal tax deduction cap workaround for passthrough entities that would also increase their state income taxes. This proposal would increase the passthrough entity tax from a 4.25 percent tax imposed at the individual level to a 6 percent tax imposed at the entity level, with a corresponding individual credit. Apparently, the credit is determined at the 4.25 percent rate, resulting in an increase in state tax revenue of about $157 million for fiscal 2020 and $217 million for fiscal 2021. The passthrough entity tax would include a deduction for the first $50,000 of passthrough entity income to benefit small businesses. This legislation is different than the elective workaround then-Gov. Rick Snyder vetoed in 2018, which reportedly would have saved passthrough entities about $190 million annually.

Minnesota: Similar to several other states, S.F. 304 would allow some federal passthrough entities to make a four-year election to file as a state C corporation. The Senate Committee on Taxes held a hearing on the bill March 14, but the Legislature has adjourned.

New Jersey: New Jersey S.B. 3246 and its companion A.B. 4807 were introduced May 16 to create an elective entity-level tax on passthrough entities. If the company elected to be taxed as a state C corporation, the owners would be entitled to claim a refundable gross income tax credit. The bill would establish four tiers of tax rates, beginning at 5.525 percent if the passthrough entity's distributive proceeds are less than $250,000 annually and increasing to 10.75 percent if the distributive proceeds exceed $3 million. The legislation would be retroactive to tax years beginning on or after January 1, 2018.

Oklahoma: On April 29 Oklahoma Gov. Kevin Stitt (R) signed into law H.B. 2665, the Oklahoma Pass-Through Entity Tax Equity Act of 2019, which adopts an optional entity-level passthrough entity tax, coordinates provisions of that tax with the state individual income tax, and makes administrative and procedural changes to implement the tax. Entities electing to be subject to the tax for tax years beginning on and after January 1, 2019, and before January 1, 2020, must file elections within 60 days of the date of enactment of the legislation. For tax years beginning on and after January 1, 2020, the election may be made during the preceding tax year or as late as two months and 15 days after the beginning of the taxpayer's tax year.

Elections are revocable as late as two months and 15 days into the taxpayer's tax year, and will relate back to the first day of the taxpayer's tax year. The tax is calculated by multiplying each partner/shareholder/member's distributive share by their applicable tax rate: the highest individual marginal rate (currently 5 percent); 6 percent for corporations, passthrough entities, or financial institutions;

or for exempt organizations, the highest marginal rate that would apply to any item of the electing passthrough entity's income or gain absent the election — and then aggregating the result.

Rhode Island: H.B. 5576, introduced February 27, would allow a passthrough entity to elect to pay a 5.99 percent income tax at the entity level. This would also allow owners to claim a state tax credit on their state personal income tax return. As of this writing, there was only one legislative day remaining.

Virginia: L. 2019, H.B. 529 (chapter 17), effective February 15, 2019, and applicable to tax years beginning on and after January 1, 2018, amends Va. Stat. Ann. section 58.1-322.03 to, among other things, include a deduction from Virginia adjusted gross income "for taxable years beginning on and after January 1, 2019, the actual amount of real and personal property taxes imposed by the Commonwealth or any other taxing jurisdiction not otherwise deducted solely on account of the dollar limitation imposed on individual deductions" by IRC section 164(b)(6)(B). This deduction effectively prevents the state from receiving a windfall resulting from a federal partial denial of a state real and personal property tax deduction.

Wisconsin: In Wisconsin DOR Tax Bulletin 204 (January 2019), the department provided interpretive guidance on the 7.9 percent elective passthrough entity tax, in particular as it applies to S corporations (referred to at the state level in Wisconsin as tax-option corporations). The bulletin provides insights on changes to the state Form 5S and Schedule 5K-1, and announces that a new Schedule 5S-ET is forthcoming. The bulletin indicates that shareholders must wait to file their 2018 returns until they receive notification from the S corporation whether it has made the election, and underpayment interest will not apply to additional tax due from S corporation shareholders for 2018 if the S corporation has elected to pay tax for the 2018 tax year. S corporations making the election must pay the tax due by the unextended deadline to avoid regular interest charges.

The election must be made by, and can be revoked by, shareholders owning at least 50 percent of the shares of the S corporation on the date of the election or revocation, respectively. If the election is made, shareholders do not include the S corporation's items of income, expense, gain, or loss in their individual income, and the S corporation must pay the tax on the items that would otherwise be taxed in the hands of the owners absent the election. Nonresident shareholders' shares of income attributable to Wisconsin are not included on the S corporation's passthrough entity tax return, and Wisconsin resident S corporation shareholders cannot take a Wisconsin tax credit for taxes paid to other states by the S corporation at the entity level on their individual returns.

Act 2017-368, enacted December 14, 2018, authorized the aforementioned passthrough-entity-level tax election. Acts 368, 369, and 370 — not to mention 82 confirmed political appointees — are being challenged as unconstitutional in *League of Women Voters v. Evers*.[4] This is one of two lawsuits in Wisconsin state courts contesting the legality of the 2018 lame-duck legislative session, and one of four such lawsuits. The plaintiffs assert the legislative session called to enact Act 368 violated both the statute governing when the Legislature may meet and the state constitution. The circuit court granted the plaintiffs' motion — joined by Gov. Tony Evers (D) — for temporary injunction and denied the Legislature's motions to dismiss and in opposition to the temporary injunction.

The case was appealed to the Wisconsin Court of Appeals, which stayed the circuit court's injunction and ordered an expedited briefing schedule. The Wisconsin Supreme Court accepted the Legislature's request to take jurisdiction in the case April 15 before the court of appeals issued a ruling. Oral arguments were held May 15.

[4] Case No. 19-CV-84 (Wis. Cir. Ct. filed Mar. 21, 2019).

III. Nexus of Nonresident Partners/Members

Kentucky: Effective February 1, 2019, the DOR finalized changes to regulation 103 Ky. Admin. Regs. 16:240 regarding the nexus standard for corporations and passthrough entities. These amendments update statutory references from the passage of L. 2018, H. 487. Further, these amendments clarify that U.S. P.L. 86-272 does not provide immunity from the Kentucky LLE tax imposed by Ky. Rev. Stat. section 141.0401, but the state does provide P.L. 86-272 protection when orders are sent out of state for acceptance or rejection and filled or shipped from outside Kentucky, "regardless of the method of shipment or delivery."

New York: On December 6, 2018, the New York City Tax Appeals Tribunal ruled that capital gains realized by a Goldman Sachs subsidiary on the sale of its minority interest in a New York City-based business were subject to $4 million in city general corporation tax. The tribunal, in a matter of first impression, found the capital gains realized on the sale were subject to the city's tax. It further concluded that taxing the gains did not violate the commerce clause or due process clause, despite the fact that the parties had stipulated that the entity doing business in New York City and the taxpayer were not part of a unitary business.

The tribunal found the benefits — such as fire and police protection — provided to the local business had a rational relationship to the gain Goldman realized on the sale of its minority interest in the business, and that the gain was attributable to the benefits provided by the city. The tribunal rejected Goldman's argument that other factors, such as the lack of a unitary relationship between the owner entity and the sold business (as stipulated by the parties), should be considered, and instead simply concluded that "nexus is sufficient."

The tribunal also found that the imposition of the tax satisfied the four-part *Complete Auto* test, which it remarked was reaffirmed in *Wayfair*.[5] Thankfully, the ruling has been appealed to the Tax Appeals Tribunal commissioners.

IV. Composite Returns/ Nonresident Partner Withholding

Arkansas: The Arkansas Department of Finance and Administration, Office of Hearings and Appeals, ruled that the DOR improperly assessed passthrough withholding tax on two disregarded entities for receiving distributions from a primary entity without Arkansas taxes first being withheld. The disregarded entities countered that they were disregarded entities for both federal and state purposes, and were not subject to Arkansas withholding. The DOR argued that the primary entity making distributions to the disregarded entities was required to withhold Arkansas tax under Ark. Code Ann. section 26-51-919, and that because this was not done, the disregarded entity was required to file an Arkansas individual income tax return reporting the distribution on Schedule C.

However, Arkansas conforms to the federal treatment of LLCs, so the disregarded entities were not required to file a separate return. Moreover, Ark. Regs. section 2006-3(E) does not require withholding when the recipient of the distribution is another passthrough entity, or if the passthrough entity is not required to file a federal income tax return. The taxpayers proved they were disregarded entities and that the Arkansas tax due was paid by their owner. For these reasons, the assessment was vacated and the case remanded.[6]

In four other decisions, however, having similar facts to the appeals in Dkt. Nos. 19-481 and 19-482, the Office of Hearings and Appeals upheld assessments against two LLCs for failure to prove all of their owners' distributive shares of income were exempt from withholding on the basis that they were below the $1,000 minimum Arkansas-source income withholding threshold or were otherwise exempt from tax. The administrative law judge found the taxpayers' provision of Schedule K-1

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[5] *In the Matter of the Petition of Goldman Sachs Petershill Fund Offshore Holdings (Delaware) Corp.*, No. TAT(H)16-9(GC) (N.Y.C. Tax App. Trib. Dec. 6, 2018).

[6] *See* Arkansas Administrative Hearing Decision, Dkt. No. 19-481 (Feb. 28, 2019); Arkansas Administrative Hearing Decision, Dkt. No. 19-482 (Feb. 28, 2019).

equivalents to all their partners for the tax years at issue was not sufficient, and affirmed the assessments.[7]

California: The FTB proposed amendments to its passthrough entity withholding regulations. These amendments would require passthrough entities to withhold for a nonresident owner's distributive share of the entity's California source income. This would increase the withholding rate from 7 percent to the highest marginal tax rate for each domestic nonresident passthrough entity owner.[8]

Hawaii: S.B. 1360 was enrolled to Gov. David Ige (D) on April 18, but became law without his signature. It generally requires partnerships to withhold income taxes from nonresident partners at the highest marginal tax rate applicable to the partner. Publicly traded partnerships are not required to withhold but are required to report to the Department of Taxation the name, address, taxpayer identification number, and any other information requested by the department for each unit holder with Hawaii income. The department is granted authority to prescribe the manner of paying the amounts withheld.

Montana: The DOR issued guidance on requesting a waiver from passthrough entity withholding. Generally, those entities are subject to withholding requirements, but an entity may qualify for a waiver. These owners must file Form PT-AGR, "Pass-Through Entity Owner Tax Agreement." An owner may file such an agreement if they are a nonresident individual, an estate, a trust, a tax-exempt entity administered outside Montana, a foreign C corporation, or a domestic second-tier passthrough entity. The owner filing the form agrees to timely report and pay any tax due on the income from the passthrough entity, and consents to the jurisdiction of the state in collecting the tax.[9]

V. Passthrough Entity Income Sourcing/ Multistate Apportionment

Nebraska: L.B. 276, introduced January 15, would end the resident exclusion for non-Nebraska-source income from an S corporation or LLC, effective for tax years beginning on and after January 1, 2020. In the meantime, however, the Legislature has adjourned.

Under current law, state residents only include in their Nebraska taxable income that portion of income from their distributive share in an S corporation or LLC sourced to Nebraska by statute and the fair compensation they receive for services rendered to the entity. This bill would require resident shareholders of the passthrough entities to include in their state taxable income the proportionate share of all the entity's federal income, as well as fair compensation for services rendered to the entity. To avoid double taxation, residents are provided a credit for income taxes paid to other states.

The Nebraska Legislative Fiscal Office estimated that L.B. 276 would raise more than $35 million in fiscal 2020 and over $85 million in fiscal 2021 and subsequent years.

New York: In a case of first impression, a New York administrative law judge held March 7 that a corporation that was the sole member of two disregarded LLCs — one an investment adviser and the other a broker-dealer — cannot use the special broker-dealer sourcing rules to source the receipts of both entities for corporation franchise tax purposes. The ALJ stated that the taxpayer had deliberately chosen to use two separate subsidiary entities for its broker-dealer and investment advisory operations because of the regulatory burdens of dual registration. Therefore, the taxpayer was "bound by the tax consequences of the form chosen." Also, the taxpayer was required to add back Brazilian withholding income tax, as the ALJ concluded that it was a tax on profits or income. The fact that the tax is imposed on "the gross amount of income without benefit of any deductions" does not prove that it is not a tax on income.[10]

[7] Arkansas Administrative Hearing Decision, Dkt. Nos. 17-483; 17-484, Apr. 4, 2019, Arkansas Administrative Hearing Decision, Dkt. Nos. 17-485; 17-486, Apr. 4, 2019.

[8] *See* Proposed Regulation 18662-7 (Mar. 15, 2019).

[9] *See* Montana DOR, "Filing for a Waiver From Pass-Through Entity Withholding" (Feb. 28, 2019).

[10] *In the Matter of BTG Pactual NY Corporation*, Determination, DTA No. 827577 (Mar. 7, 2019).

New Jersey: On January 31 the New Jersey Superior Court upheld the New Jersey Tax Court's decision in *Xylem Dewatering Solutions Inc. v. Director, Division of Taxation*,[11] finding that the gain from the IRC section 338(h)(10) deemed sale of assets of a New Jersey S corporation owned by a nonresident was "non-operational" income allocable entirely to New Jersey as the corporation's domiciliary state and was New Jersey-source income for gross income tax purposes in the 2009 tax year.

The Tax Court had found that the corporation business statutes — rather than the gross income tax statutes — applied to the allocation of income from the sale. Under the statutes and case law for tax years before an amendment effective July 1, 2014, the income was properly sourced entirely to New Jersey. Notably, the appellate court commented that the Tax Court overstated the level of deference the Division of Taxation should be afforded in its construction of tax statutes. Nevertheless, it found there was no reversible error because the Tax Court thoroughly analyzed each issue before independently ruling on the law.[12]

VI. More on State-Federal Partnership Audit Rules Conformity

Multistate Tax Commission Effort: The Multistate Tax Commission on January 24 adopted a model statute for reporting state partnership adjustments resulting from federal audit changes and other changes to federal taxable income. This model statute[13] provides rules for reporting changes to partnership taxable income to the state and affected partners. Further, there is an election to pay any resulting income tax liability at the partnership level.

The model statute comes in response to the federal partnership auditing procedures that were effective January 1, 2018.[14] The MTC website is an excellent source — including the effort's history, links to articles and reports on the various issues, and citations to state laws conforming in whole or in part to the federal partnership audit rules.

California: On February 2 the FTB advised practitioners that it added to the California 2018 Form 565, "Partnership Return of Income," and Form 568, "Limited Liability Company Return of Income," a new line: partnership-level tax. The purpose of this line is to allow partnerships and LLCs classified as partnerships to report to the FTB each change or correction made by the IRS under the new federal centralized partnership audit regime. Each change should be reported to the FTB within 6 months after the date of each final federal determination.

On the legislative front, a technical corrections bill (S.B. 790) was introduced to "tweak" portions of the partnership audit statute passed last year (S.B. 274). The Senate approved the bill May 9.

Georgia: Effective January 30 the Georgia DOR amended Ga. Comp. R. & Regs. 560-7-3-.11, which implements the state-level administration of audits of partnership entities under the federal Bipartisan Budget Act of 2015. This regulation now allows the partnership to irrevocably elect to pay the Georgia income tax of its partners, or for the partners to elect to pay their share of the partnership's tax. The regulation provides detailed guidance on the election, which requires the partnership to file an amended return. It also specifies how to complete the required amended return, including a schedule specifying:

- the amount of any federal adjustment and positive reallocation adjustments with any modifications;
- the extent to which the additional income is allocated to Georgia;
- the apportionment ratio of the entity;
- the name, federal employee identification number, and taxpayer type for each of its partners; and

[11] Dkt No. 0057-2016, 30 N.J. Tax 41 (2017).

[12] *See Paz v. Division of Taxation*, Dkt. No. A-5552-16T4 (N.J. Super. Ct., App. Div. Jan. 31, 2019).

[13] The model statute was the result of a two-year effort by a working group including the MTC, Council On State Taxation, Tax Executives Institute, American Institute of CPAs, Institute of Professionals in Taxation, and a task force of the American Bar Association Section of Taxation's State and Local Taxes Committee (of which the authors were co-chairs).

[14] *See* MTC, "Model Uniform Statute for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments," adopted Jan. 24, 2019.

- for EO partners, whether the allocated income constitutes unrelated business taxable income.

The regulation further provides guidance on reporting federal adjustments, as well as requirements for written statements to partners.

On the legislative front, a technical corrections bill (H.B. 419) was signed into law by Gov. Brian Kemp (R) on May 7. The new law revises provisions of the 2018 law regarding tiered partnerships. Changes include requiring electing partnership and tiered partners to notify each of their direct partners of their distributive share of federal adjustments, and making a partnership's or tiered partners' election to pay the state tax irrevocable.

Minnesota: S.F. 2555, filed March 18, would encapsulate the DOR's approach to addressing the recent federal partnership audit rules, including allowing it to make non-IRS changes after the general statute of limitations has expired. The legislation fails to adequately address tiered partnerships, as it would require them to know the residency of all tiered partners. This legislation is a companion bill to H.F. 2169. Another effort in Minnesota to address partnership audits is H.F. 1486/SF 1522, which largely tracks the MTC model act. In the meantime, the Legislature has adjourned.

Missouri: S.B. 220 adopted reporting requirements for partnerships subject to the new federal audit procedures and took effect for tax years beginning on and after January 1, 2018.

Ohio: On May 9 the House of Representatives passed the state's two-year budget bill (Am. Sub. H.B. 166), which partially conforms to the MTC model statute — with modifications. As of this writing, the bill is pending in the Senate.

Oregon: On May 22 Gov. Brown signed H.B. 2101 into law as Oregon's version of the MTC model legislation that provides for state conformity to the new federal partnership audit rules that went into effect in 2018. H.B. 2101 follows the MTC model statute's default rule of generally requiring the partners to pay tax at the state level. However, it also provides for a partnership-level payment election.

West Virginia: On March 9 West Virginia enacted S.B. 499, a 71-page bill designed to conform its partnership tax law to federal partnership tax law for tax years after December 31, 2018. The legislation amends the West Virginia Tax Procedures and Administration Act, Personal Income Tax Act, and Corporation Net Income Tax Act to enable tax collection on passthrough entities and their partners resulting from federal audits. This legislation addresses:

- allocation and apportionment of income of nonresidents from multistate business activities;
- special apportionment rules;
- filing refund or credit claims when reporting a change in federal taxable income;
- reporting changes in taxes paid to other states;
- withholding tax for publicly traded partnerships;
- reporting federal adjustments for partnership level audits;
- a de minimis exception;
- tax assessments arising from federal taxable income adjustments;
- statute of limitations;
- estimated tax payments during a federal audit;
- the scope of adjustments; and
- refund or credit claims arising from federal adjustments.

S.B. 499 was based on the MTC's model statute.[15] West Virginia State Tax Deptartment Administrative Notice No. 2019-22 (April 25, 2019) provides interpretive guidance on the department's implementation of these provisions.

VII. Update on Series LLCs

Iowa: Effective July 1, 2020, Iowa will allow the creation of a "protected series" of a series LLC that has the same powers and purposes as an LLC, but is distinct from the LLC, another protected series of the LLC, a member of the LLC, a protected-series transferee, or a

[15] *See* L. 2019, S.B. 499.

transferee of a transferable interest of the LLC. A protected series is established by the affirmative vote or consent of all members of the LLC and by the filing of a protected series designation with the secretary of state stating the name of the LLC and the name of the protected series to be established. A series LLC must include the name of each protected series of the LLC in its biennial report. The act provides for the limitation of liability and enforcement of claims, dissolution and winding up of a protected series, restrictions on transactions that a protected series may enter into, mergers, and the formation of a foreign protected series.[16]

Virginia: Effective July 1, 2020, Virginia will allow for the creation of a "protected series" by an LLC, which must be approved by the affirmative vote or consent of all members. This protected series is deemed an LLC that is separately organized and distinct from the series LLC. Only a member of a series LLC may be an associated member of a protected series. An LLC must deliver to the State Corporation Commission of Virginia a filing statement to establish a protected series. This filing statement must include the name of the LLC, the name of the protected series being established, the post office address of the principal office of the protected series, and a statement that the establishment of the protected series was approved by all members of the LLC.[17]

Final Treasury Regs on Series LLCs: Will they ever be issued?

VIII. Miscellaneous Updates

California: The TCJA repealed IRC section 708(b)(1)(B), known as the partnership technical termination provision. Thus, the sale or exchange of 50 percent or greater interest in a partnership will neither terminate the partnership nor end its tax year. Therefore, no federal short-period return is due. Not all states conform to this change; therefore, some partnerships will experience a state-only technical termination that requires a state short-period return. The FTB said in July 2018 that "a partnership for California purposes will still be treated as terminated if within any 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits." So for California purposes, short-period returns would still be required.

Iowa: The DOR issued guidance on Iowa's 2018 nonconformity to the federal IRC section 163(j) interest deductibility limitation. For passthrough entities, adjustments must be reported on Form 42-029, "2018 Nonconformity Adjustments Worksheet," line 3. Because partnerships are not allowed to carry the disallowed deduction forward to future tax years, they must report the excess to their partners, and the partners must make adjustments to their respective interest expense limitations, if any, in future years. However, Iowa *will* conform to IRC section 163(j) for 2019 and in the future. A taxpayer's Iowa interest expense deduction for any given tax year after 2018 generally will match the federal deduction, except for taxpayers who deducted the full amount of interest expense in 2018. These taxpayers will have to make adjustments to federal 2018 carryforward amounts claimed in 2019 and subsequent years.

Maryland: The comptroller issued a tax alert addressing how global intangible low-taxed income is reported on the corporation, passthrough entity, and individual income tax returns in Maryland. Because GILTI is in federal AGI and is not a dividend or deemed dividend eligible for Maryland's dividend subtraction, it generally will be taxed in Maryland.

For passthrough entities, the entire amount of GILTI is in Maryland taxable income. However, passthrough entities are not eligible for the IRC section 250 deduction, and no foreign tax credit is available. The Maryland passthrough entity return, Form 510, begins with the entity's total distributive share of income on the applicable federal return, so the GILTI in the entity's federal return will carry through to the Maryland Form 510. GILTI is in income regardless of the entity's allocation method. Passthrough entities using the statutory apportionment formula must include

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[16] *See* L. 2019, S. 569.

[17] *See* L. 2019, H. 2271 (c. 636).

GILTI in the denominator. GILTI is in the numerator based on the average of the property and payroll factors.

The comptroller may alter the entity's apportionment formula or its components if the resulting formula does not fairly represent the entity's activity in Maryland. The comptroller may accept a reasonable method of allocating a portion of GILTI to Maryland for entities using separate accounting.

Minnesota: Similar to the California technical termination update discussed above, a DOR statement said that "Minnesota law has not changed. Under Minnesota law, a technical termination occurs if a partnership has a sale or exchange of 50 percent or more of the total interest in the partnership capital and profits within any 12-month period. If a technical termination happens mid-year, the partnership must file two short period returns for Minnesota, but will not have short taxable years for federal tax purposes."

New Jersey: A Division of Taxation pronouncement addresses the application of IRC section 965 and IRC section 951A to New Jersey taxpayers, including passthrough entities. For IRC section 965, deemed repatriation dividends are reported for an S corporation in New Jersey at the same time and in the same amount as for federal purposes. Also, the IRC section 965(c) deduction is permitted to S corporation shareholders. For a partnership, IRC section 965 deemed repatriation dividends are reported in New Jersey at the same time and in the same amount as for federal purposes. However, the New Jersey Gross Income Tax Act does not allow for the IRC section 965(c) deduction for partnerships, and there is no comparable New Jersey state deduction. For S corporations, GILTI imposed under IRC section 951A is reported in the same tax year and in the same amount as for federal purposes. For other taxpayers, GILTI is reported as dividend income in New Jersey when the taxpayer actually distributes the income from earnings and profits.

In the same release, the agency stated that the TCJA business interest limitations in IRC section 163(j) do not apply to partnerships doing business in New Jersey. A partnership may deduct the entire amount of its interest expense within the tax year and should report the federally disallowed amount as an "other subtraction." In the year when the disallowed amount carried forward is deducted for federal tax purposes, the amount must be added back as an "other addition" on Form NJ-1065 to prevent the amount from being claimed twice.

Texas: The Comptroller of Public Accounts issued guidance on whether a joint ownership agreement creates a taxable entity for Texas franchise tax purposes. Here, the taxpayer was a trustee who received legal title to Texas real property as an agent for five co-owners through an agreement. The purpose of the agreement was to enable the management of the property and related expenses, and the taxpayer was the agent for convenience only. This activity was reported on IRS Form 1065, but the taxpayer elected to be excluded from federal partnership tax treatment. The comptroller said that the taxpayer's co-ownership arrangement was not a taxable entity for Texas franchise tax purposes because the taxpayer is a nominee who is not a legal entity, because the taxpayer's entity is not a partnership, and because the taxpayer does not meet the definition of joint venture.[18] ■

[18] *See* Texas Private Letter Ruling No. 201902008L (Feb. 13, 2019) (released Mar. 2019).