

# Current Developments Involving Pass-through Entities: Partnerships, LLCs, Subchapter S

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## The Goal: Achieving Partnership/LLC Self-confidence



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## LLCs and LLPs

### General Principles of Partnership Taxation

- ◆ Treatment of Entity
- ◆ Partner Filing Responsibilities

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## LLCs and LLPs

### Treatment of Entity

Most states do not subject the partnership itself to an entity-level tax, but they do generally require that the partnership file an informational return

Among the states which do subject the partnership itself to an entity level tax (other than a minimum filing fee or surcharge):

- **District of Columbia**
- **Illinois (replacement income tax only)**
- **Michigan**
- **New Hampshire**
- **Tennessee (non-corporate entities with limited liability only)**

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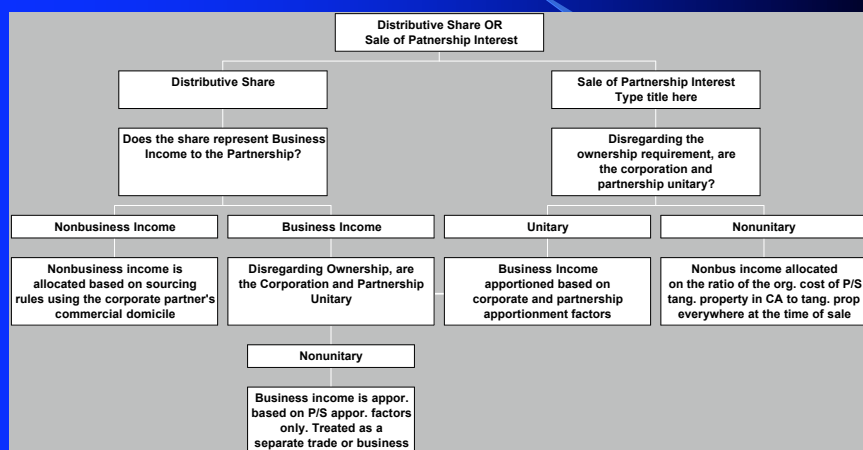
## LLCs and LLPs

### Taxation of Corporate Partners

- ◆ Does Mere Ownership Create Nexus
- ◆ Income Classification
- ◆ Methods of Attributing Partnership Income
- ◆ Sourcing of Nonbusiness Partnership Income

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## Partnership Taxation



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## State Taxation of Partners

### Historical Overview

- ◆ Grounded in business law characteristics of general partnerships
- ◆ Partnerships as an extension of its owners
  - Mutual agency
  - Property ownership
  - Direct management & control
- ◆ Conclusion: partners doing business in the state(s) where the partnership operated

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## State Taxation of Partners

### Nexus Issues

- LLC—Corporation or Partnership
  - More like a corporation—no nexus?
  - More like a partnership—nexus?
- State law issue
  - Has state imposed tax on LLC owner?
- Constitutional issue
  - Does state have authority to tax?

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## Nexus For Corporate Partners

- ◆ Each state generally determines its own nexus rules (subject to constitutional limitations)
- ◆ “Entity Concept” - corporate partners and partnership treated as separate entities
- ◆ “Aggregate or Conduit Concept” - corporate partners treated as having ratable share of the partnership items



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## Nexus For Corporate Partners

- ◆ Corporate general partners almost always have nexus
- ◆ Certain states may not assert nexus for corporate limited partners of *operational* limited partnerships
- ◆ Certain states may not assert nexus for corporate limited partners of *investment* limited partnership



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## Cases Bearing on Possible Constitutional Question of Taxing Corporate Owners

Rulings of interest . . .

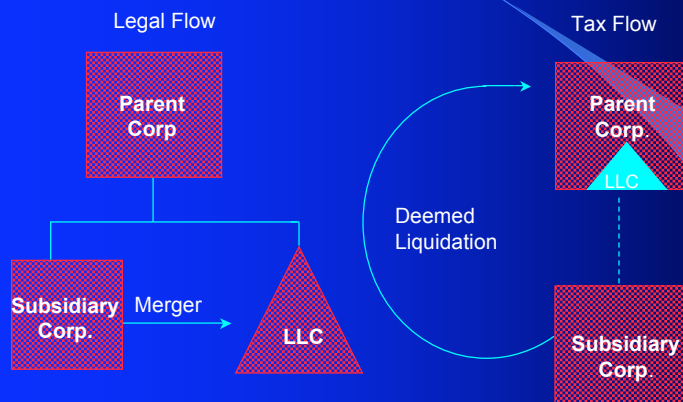
- ◆ *Matter of Just Born, Inc.*, NYC Tax App. Trib., 3/30/98 (taxpayer selling into NYC not subject to tax as a result of being LP in unrelated partnership with NY real estate)
- ◆ *Agley v. Tracey*, 87 Ohio St.3d 265 (1999) (non resident subS shareholder subject to tax)
- ◆ *Appeals of Amman & Schmid Finanz AG et al.*, CA State Board of Equalization, No. 96-SBE-008, 4/11/96 (LP not "doing business" just because partnership was)
- ◆ *Valentino v. FTB*, (subS shareholder taxable and source of income is where corporation operates, not location of stock)



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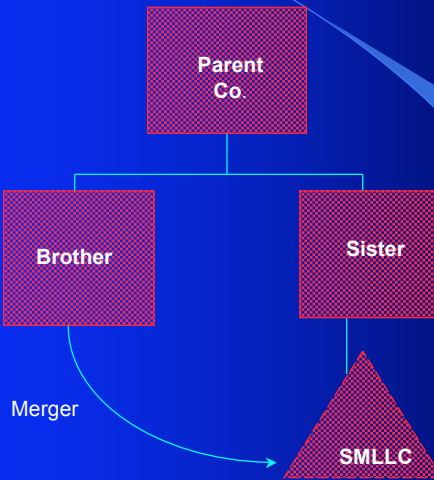
## Subsidiary of Parent Merges/Converts into Parent's SMLLC



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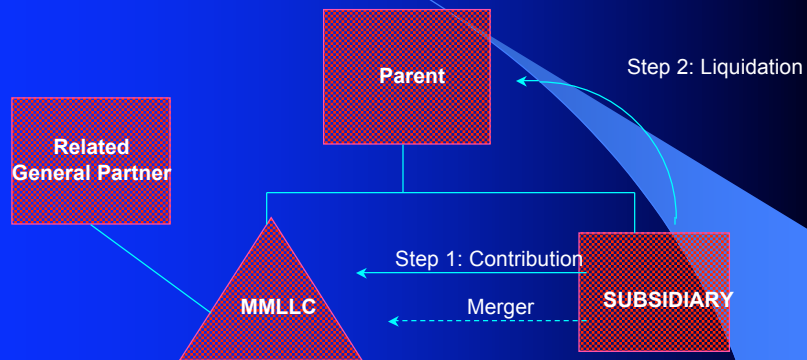
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## Brother Subsidiary Merges/Converts Into Sister Subsidiary's SMLLC



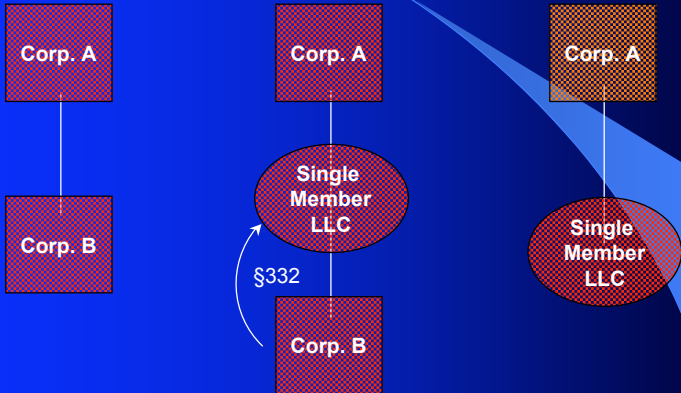
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## Corporation Merges/Converts into MMLLC (or State Law Partnership)



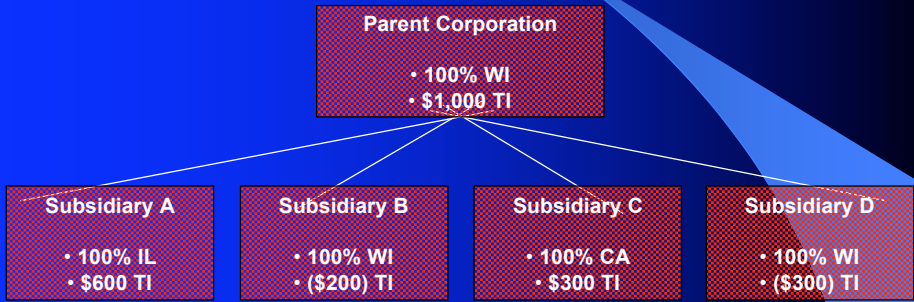
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# Simplified Restructuring



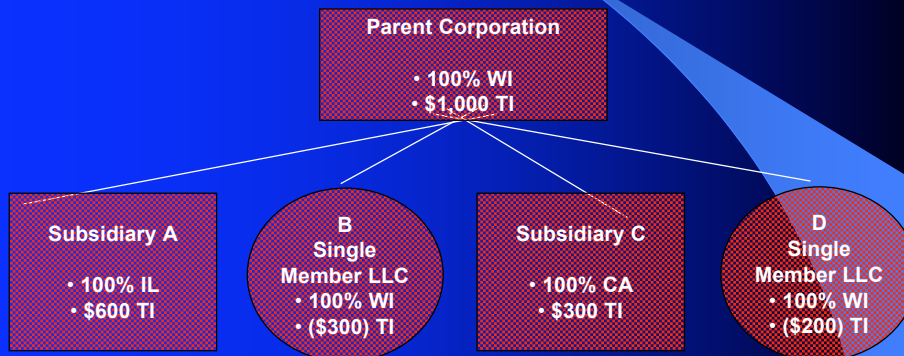
- Convert B Corporation to a single member LLC while maintaining liability shield

# Customized Returns in Separate Filing States



- Parent corporation has \$1,000 Wisconsin Taxable Income

## Customized Returns in Separate Filing States (cont.)



- ♦ Parent corporation has \$500 Wisconsin Taxable Income

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## Passive Investment Company Opportunities

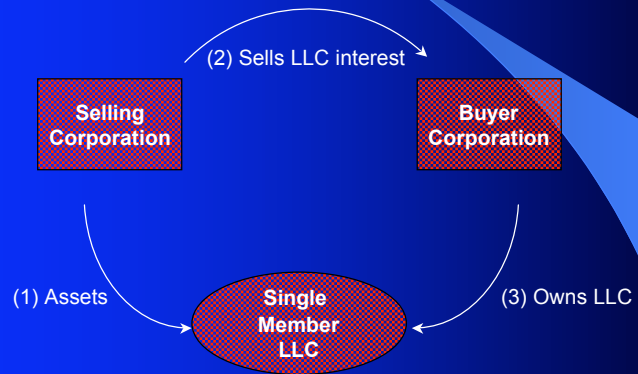


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# Transactional Based Taxes

(Sales/Use & Real Estate Transfer)



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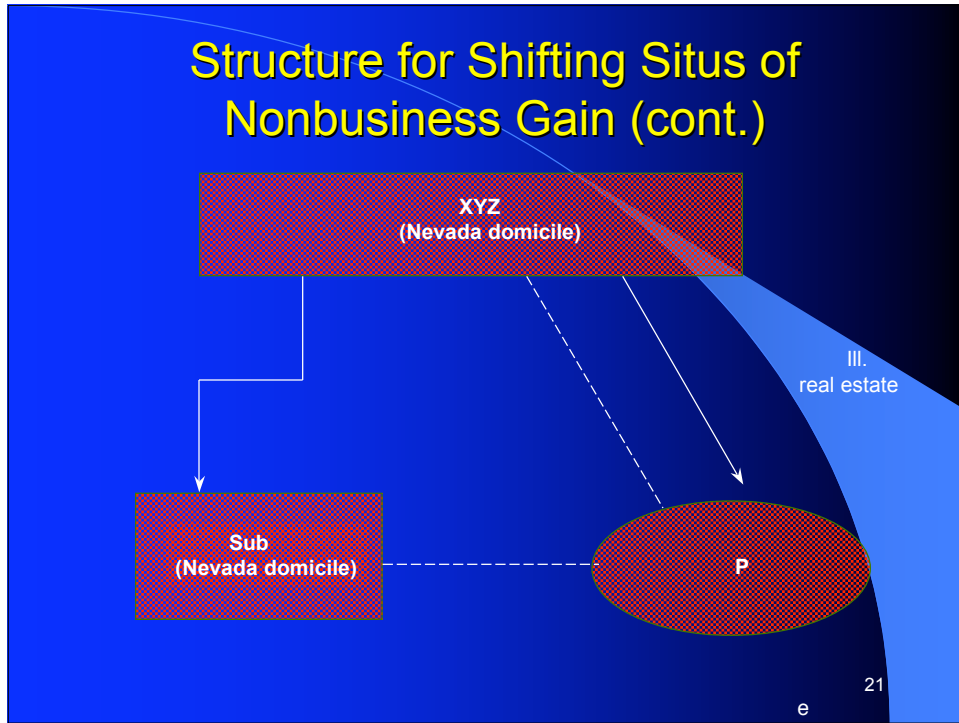
# Structures for Shifting Situs of Nonbusiness Gain



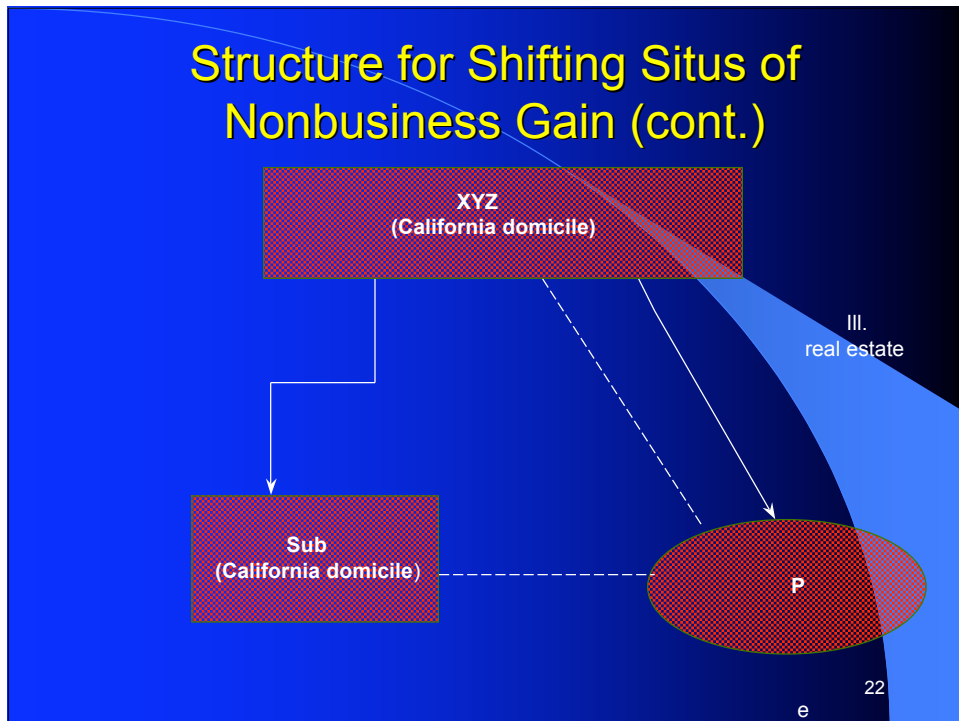
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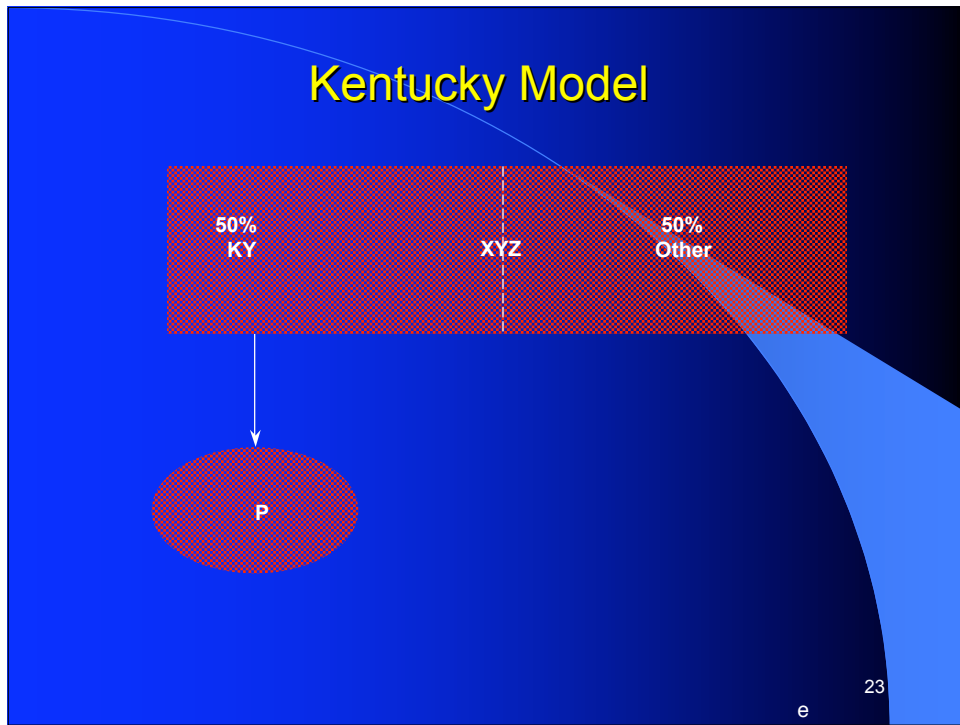
## Structure for Shifting Situs of Nonbusiness Gain (cont.)



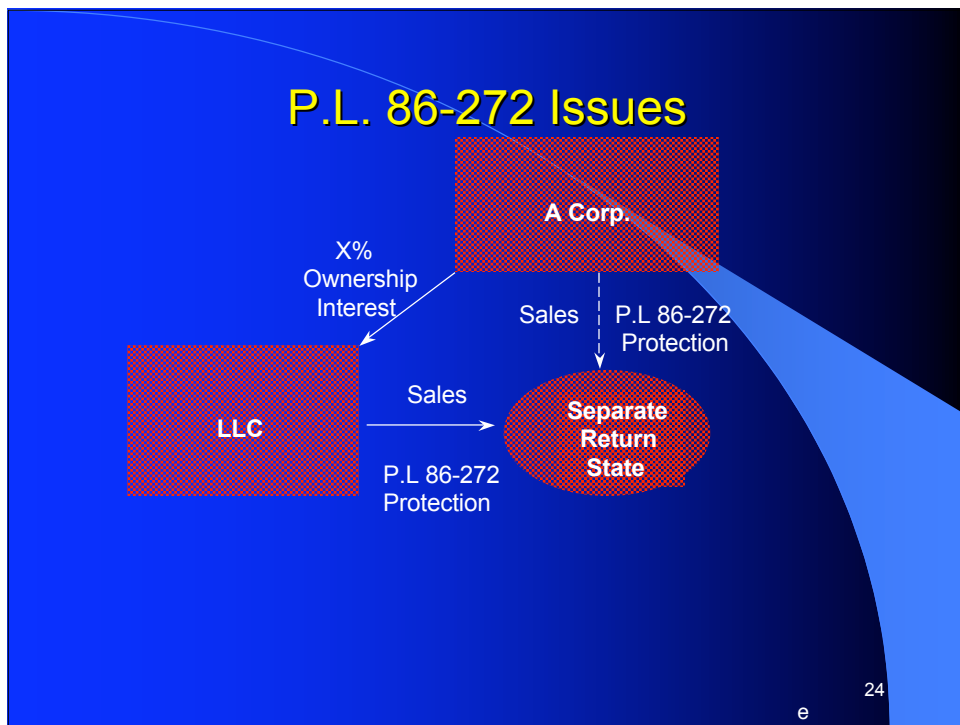
## Structure for Shifting Situs of Nonbusiness Gain (cont.)



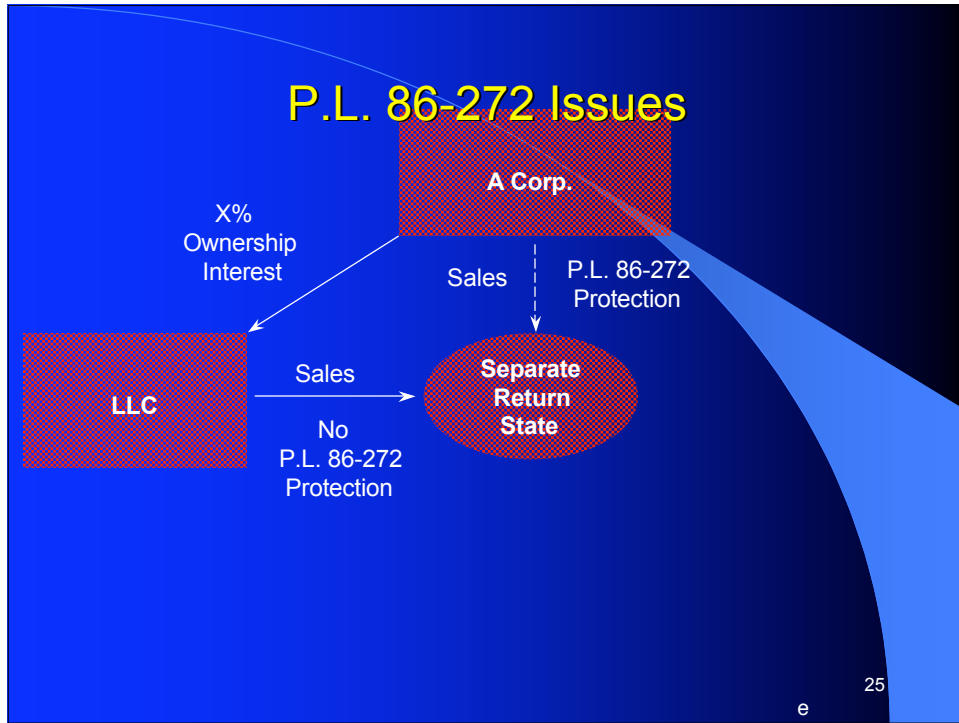
## Kentucky Model



## P.L. 86-272 Issues



## P.L. 86-272 Issues



## P.L. 86-272 Issues

