



Private Letter Ruling
Redacted Version
No. 08-009

Individual Income Tax
Allocation of Partnership Income Between States
July 25, 2008

This is in reply to your request for a private letter ruling concerning whether or not the Louisiana Department of Revenue will accept the distribution of income as set out in Section XX of the Amended and Restated Articles of Partnership effective January 1, 2007.

FACTUAL SCENARIO

You provided these facts:

Partnership A is a Louisiana limited liability partnership with offices in Louisiana and several states that do not have a state income tax. As of January 1, 2008, Partnership A had (a number) partners and approximately (a number) employees. The partners and employees are assigned to one or more of Partnership A's offices in the above-referenced states. Partners who work in one of Partnership A's Louisiana offices are domiciled in and residents of Louisiana. Partners who work in one of Partnership A's non-Louisiana offices are domiciled in and residents of states other than Louisiana.

There are two classes of partners at Partnership A – Equity Partners and Income Partners.¹ For federal and state income tax purposes, the Income Partners are treated as employees and the Equity Partners are treated as full partners and not employees. For purposes of this Ruling Request, we will address only Equity Partners.

Equity Partners who are assigned to one or more of the Partnership's non-Louisiana offices generally provide all of their services in those states. They do not regularly practice in Louisiana. They may occasionally travel to Louisiana for meetings with clients in Louisiana or to attend Partnership-related functions in Louisiana, but they generally do not work out of any office in or generate any revenues from services performed in Louisiana. Thus, for example, an Equity Partner who works in one of Partnership A's offices in State X performs substantially all of his or her professional services and generates substantially all of his or her revenues in State X.

¹ All capitalized terms herein have the meaning set forth in the Articles.

All aspects of Partnership governance, including provisions regarding distributions to partners, are set forth in Partnership A's Articles of Partnership. Partnership A is governed by a Board of Directors (the "Board"). The Articles gives the Board the authority to determine the amount of Equity Partners Net Income ("EPNI"). EPNI is defined in the Articles to mean "the net income of the Partnership ... available for distribution to the Active Equity Partners, as determined from time to time by the Board"

Distributions of EPNI to Equity Partners are made in accordance with the provisions of the Articles. Essentially, each Equity Partner's distributive share of EPNI for a particular year is that Equity Partner's Net Income Share, which is determined by multiplying each Partner's Percentage Interest by the EPNI for the entire year, as finally determined the Board. In other words, each Equity Partner's distributive share of EPNI is the Equity Partner's Percentage Interest in the Partnership.

In order to properly attribute Partnership income to Equity Partners based on where the Equity Partners are domiciled, perform professional services and produce revenues for the Partnership, the Articles were amended effective January 1, 2007, to add the following new Section XX to the Articles:

Income Sourced To Active Equity Partners In Each State.

- (a) All items of income, gain, loss or deduction shall be allocated among Active Equity Partners in proportion to their Percentage Interests.
- (b) Equity Partners' Net Income shall be sourced to each state (including State X) in accordance with applicable law.
- (c) The portion of Equity Partners' Net Income sourced to a particular state ("Domicile State Component") shall be allocated first to the Active Equity Partners who are domiciled in that state ("Domicile State Partners").
- (d) If a Domicile State Component exceeds the aggregate Net Income Shares of its Domicile State Partners, the excess shall be reallocated to Active Equity Partners domiciled in other states, up to but no more than their aggregate Net Income Shares, in proportion to the shortfalls in those other states.
- (e) Domicile State Partners shall share in proportion to their Percentage Interests the portion of Equity Partners' Net Income allocated to them from their Domicile State Component and from other states.
- (f) This Section shall be effective, to the greatest extent permitted under applicable law, as of January 1, 2007, or as soon thereafter as possible.

(g) The Board of Directors shall have the authority to interpret and implement this Section consistent with applicable law.

For 2007 and thereafter, the Partnership will determine each Equity Partner's distributive share of EPNI in accordance with the provisions of the Articles, as amended. In essence, distributions of EPNI will be made as follows:

1. The Partnership will allocate and apportion income within and without Louisiana based on the provisions of La. R.S. 47:241 *et seq.*² The vast majority of the Partnership's income is and will continue to be apportionable income as defined in La. R.S. 47:242(2). The Partnership will apportion its apportionable income within and without Louisiana based on the two-factor formula set forth in La. R.S. 47:245(D).
2. After allocating and apportioning its income within and without Louisiana as described above, the Partnership will further attribute its income among the various states in which the Partnership operates based on the where the income actually was generated. Thus, in essence, the Partnership will create multiple "buckets" of income, one each for Louisiana and the other states where Partnership A has offices.³ The amounts that go into each bucket will be determined based on where the income was actually generated.⁴ Thus, for example, income generated by Louisiana partners will be attributed to the Louisiana "bucket." The same will apply for the remaining states. After this step, the Partnership essentially will have multiple "buckets" of EPNI, one for each state in which the Partnership operates.
3. Pursuant to the Articles, Active Equity Partners domiciled in each state will first be distributed their Percentage Interests of EPNI from the EPNI "bucket" of their state.⁵ If the Domicile State Partners' distributive shares of Partnership EPNI is greater than the EPNI of their state's "bucket," *i.e.*, the Domicile State Component, then such Domicile State Partners will be distributed EPNI from each of the other state "buckets" to the extent there is otherwise undistributed EPNI in a state "bucket."⁶ For example, assume that the Partnership generates \$1,000,000 of EPNI in 2007 from its non Louisiana State X bucket, it has Domicile State Partners who work in the State X offices, and each of the State X-based Domicile State Partners is entitled to a distribution of \$400,000 of Partnership EPNI. Based on this example, each of the State X-based Domicile State Partner's distributable share of EPNI would come entirely from the State X "bucket," *i.e.*, the State X Domicile State Component, and those State X-based Domicile State Partners would have only

² See the Articles.

³ The portion of EPNI sourced to a particular state is referred to in the Articles as the "Domicile State Component." In this letter, a Domicile State Component is referred to as a "bucket."

⁴ See the Articles.

⁵ Active Equity Partners who are domiciled in a particular state are referred to in the Articles as "Domicile State Partners."

⁶ See Section XX (c) and (d).

State X-source EPNI. None of the State X-based Domicile State Partner's distributable share of EPNI would be from any of the other state buckets. Conversely, if the Partnership generates only \$600,000 of EPNI in 2007 from its State X offices, each of the two State X-based Domicile State Partners would be distributed \$300,000 of State X-sourced EPNI and the other \$100,000 of distributable EPNI to each of the State X-based Domicile State Partners would come proportionately from the other state "buckets" to the extent there is any undistributed EPNI in the other states' buckets.

Again, the purpose for the sourcing of income as described above and as specifically addressed is to attribute the Partnership's income to the geographic "buckets" that are associated with the Partnership's offices in Louisiana and various other states based on where the Partnership's income is actually generated. This type of attribution or sourcing of income more clearly reflects how the Partnership operates and generates its revenues.

TAXPAYER'S DISCUSSION/ANALYSIS

Louisiana Taxation of Individual Partners

A Louisiana resident individual must report and pay Louisiana individual income tax on all of his or her income from whatever source derived. La. R.S. 47:290(B). A nonresident individual must report and pay Louisiana individual income tax only on his or her income earned within or derived from sources in Louisiana. *Id.*

A partnership is not subject to Louisiana income tax. La. R.S. 47:201. A partnership that has any partner that is not an individual or any nonresident individual partner, however, is required to file a partnership return of income. *Id.* Persons carrying on business as partners are liable for Louisiana income tax only in their separate or individual capacities. As discussed below, however, certain partnerships are required to file composite returns for nonresident partners. La. R.S. 47:201.1.

A partnership that is required to file a return of income (*i.e.*, any partnership that has either a corporation or nonresident individual as a partner) is required to allocate and apportion its income within and without Louisiana at the partnership-level as if it were a corporation. La. R.S. 47:243(A) (6). Each partner then must report and pay Louisiana individual income tax on his or her distributive share of the Louisiana source net income of the partnership, which is treated as Louisiana allocable income on such partner's return. *Id.*

For a service-based partnership, income generally is apportioned within and without Louisiana using a two-factor formula – payroll and revenues. La. R.S. 47:245(D). The payroll factor is the ratio of the amount paid by the taxpayer for salaries, wages, and other compensation for personal services rendered in Louisiana, to the total amount paid by the taxpayer for salaries, wages, and other compensation for personal services in connection with the production of the net apportionable income. La. R.S. 47:245(D) (1). The revenue

factor is the ratio of the gross apportionable income of the taxpayer from Louisiana sources to the total gross apportionable income of the taxpayer.

Louisiana Composite Partnership Return for Nonresident Partners

Any partnership⁷ that engages in activities in Louisiana is required to file a composite partnership return⁸ and make a composite payment⁹ of individual income tax on behalf of its nonresident partners unless, among other things, all nonresident partners have a valid, written agreement on file with the Department pursuant to which the nonresident partner agrees to file a Louisiana individual income tax return and pay Louisiana individual income tax on all income derived from or attributable to sources in Louisiana.¹⁰ The composite return must include all nonresident partners who do not have a valid filing agreement on file with the Department and may include resident partners. La. R.S. 47:201.1(A) (1); LAC 61.I.1401(C).

A partnership that is required to file a composite return is required to make composite payments on behalf of all of its nonresident partners who do not execute and deliver a filing agreement to the partnership. La. R.S. 47:201.1(A) (1); LAC 61.I.1401(C) (1). Each partner's share of the composite payment is the maximum tax rate for individuals (currently 6%) multiplied by the partner's share¹¹ of partnership income that was derived from or attributable to sources in Louisiana, as reflected on the partnership's return for the taxable period. La. R.S. 47:201.1(D) (1); LAC 61.I.1401 (D) (3). This computation is required whether or not the partnership income is distributed. *Id.* The composite payment required to be made by the partnership is the sum of each partner's share of the composite payment for all partners included in the composite return. LAC 61:I.1401 (D) (4).

Any composite payment made by a partnership is considered to be a payment by the nonresident partner on account of the Louisiana individual income tax imposed on the nonresident partner for the taxable period. La. R.S. 47:201.1(D) (3); LAC 61.I.1401 (D) (5). To the extent that a composite payment made by a partnership on behalf of a nonresident partner exceeds the Louisiana individual income tax liability of the nonresident partner, that nonresident partner is entitled to a refund or credit for the overpayment. La. R.S.

⁷ The term "partnership" includes a registered limited liability partnership, such as the Partnership. La. R.S. 47:201.1(A) (2) (a).

⁸ A "composite return" means "a return filed by an entity treated as a partnership on behalf of all of its nonresident partners or members which reports and remits the Louisiana income tax of the nonresident partner or member."

⁹ A "composite payment" is "a payment filed with a composite return which remits the Louisiana income tax of a partnership's nonresident partner or member." Thus, a composite payment is a payment of the individual, nonresident partner's Louisiana individual income tax liability and is not a payment of any tax due by the partnership.

¹⁰ The Partnership currently obtains such agreements from each non-Louisiana partner and, therefore, does not file a Louisiana composite partnership return.

¹¹ This term is not defined in La. R.S. 47:201.1.

47:201.1(D) (3). A partnership that makes a composite payment of income tax on behalf of a nonresident partner is entitled to recover the amount paid by the partnership, plus interest or penalty, from the nonresident partner on whose behalf the payment was made. La. R.S. 47:201.1(D) (2).

Partner's Share of Partnership Income

For purposes of determining a partner's Louisiana individual income tax, the partner must take into account his or her distributive share, whether or not distributed, of the partnership's, *inter alia*, taxable income or loss and other items of income, gain, loss, deduction or credit. La. R.S. 47:202(A). A partner's distributive share of income, gain, loss, deduction or credit generally is determined by the partnership agreement. La. R.S. 47:204(A). An exception to the general rule is set forth in La. R.S. 47:204(B), which provides as follows:

B. Distributive share determined by income or loss ratio. A partner's distributive share of any item of income, gain, loss, or deduction shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in R.S. 47:202 A(4), for the taxable year, if:

- (1) the partnership agreement does not provide as to the partner's distributive share of such item, or
- (2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such item is the avoidance or evasion of any tax imposed by this Chapter.

There are no Louisiana regulations or other administrative interpretations with respect to the provisions of La. R.S. 47:204(B).

Thus, under Louisiana law, the provisions of the Articles will determine an Equity Partners' distributive shares of EPNI unless one of the two exceptions in La. R.S. 47:202A (4) applies. The first exception clearly does not apply because of the Articles, as amended effective January 1, 2007. These sourcing provisions are discussed above and clearly must be taken into account for purposes of determining a particular Equity Partner's share of Louisiana-source EPNI.

The second exception does not apply because the principal purpose of the provisions in the Articles is to provide a mechanism for Partnership A to attribute and distribute EPNI to all Equity Partners based on the geographical region in which the Equity Partners generate EPNI. The purpose of the provisions of the Articles is to neither avoid nor evade Louisiana individual income tax. Equity Partners domiciled in the other states will continue to file Louisiana individual income tax returns and pay Louisiana individual

income tax on their distributive shares of Louisiana source income, if any, from the Partnership.

Non-Louisiana source EPNI will be properly distributed to the non-Louisiana Equity Partners because their efforts generated the EPNI in the state of their domicile. Louisiana Equity Partners will file Louisiana individual income tax returns and pay Louisiana individual income tax on their distributive shares of EPNI regardless whether the EPNI is sourced to Louisiana or to other states.

TAXPAYER'S CONCLUSION

Based on the foregoing, we respectfully request that the Department rule that the provisions for distributing EPNI set forth in the Articles will be respected for Louisiana individual income tax purposes and all Equity Partners domiciled outside Louisiana should report his or her Louisiana-source EPNI from the Partnership in accordance with the provisions of the Articles.

RULING REQUESTED

The provisions for distributing EPNI set forth in the Articles, including Section XX, will be respected for Louisiana individual income tax purposes and all Equity Partners domiciled outside Louisiana should report his or her Louisiana-source EPNI from the Partnership in accordance with the provisions of the Articles.

RULING

The taxpayer properly states Louisiana tax law as it relates to the taxation of income from a partnership. The taxpayer also correctly sets out the two-factor apportionment formula used for partnerships as set out in La. R.S. 47:245(D). Finally, the taxpayer accurately states that the provisions of La. R.S. 47:204 allow a partnership to determine each partner's share of distributive income according to its partnership agreement. The only way the Department will not honor this distribution is if the principal purpose of the allocation is the avoidance or evasion of any tax.

In this case, Partnership A's Articles set out its distribution of partnership income. The Department of Revenue agrees that the principal purpose of the distribution provisions is not to avoid or evade tax, but the purpose is to attribute and distribute EPNI based on the geographical region in which the equity partner worked to generate the EPNI in question. Based on this analysis, the provisions for distributing EPNI as set forth in the Articles will be respected by the Department of Revenue for Louisiana individual income tax purposes and all Equity Partners domiciled outside of Louisiana should report his or her Louisiana-source EPNI from the Partnership in accordance with the Articles, including the provisions of Section XX.

Under the facts as presented, Louisiana will still collect tax on 100 percent of the Louisiana apportioned EPNI because all of the other states in which Partnership A has an office do not have an individual income tax; therefore, no Equity Partners domiciled in Louisiana will be eligible to claim the income tax credit for taxes paid to another state. But even in

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the case that Partnership A had an office in a state with an individual income tax that did not recognize the distributions of EPNI under the Articles, which might allow Louisiana Equity Partners to claim the credit for taxes paid to another state, the Department would still honor the distribution provisions of the partnership agreement, including Section XX, even though Louisiana would collect less individual income tax. In this case the root cause of the reduced Louisiana income tax collection is not the method of the distribution of partnership income but instead the character of La. R.S. 47:33, which allows the credit for income taxes paid to another state.

If you have any questions or need additional information, please call Michael Pearson, Senior Policy Consultant or Danielle B. Clapinski, Attorney, Policy Services Division, at 219-2780.

Sincerely,

Cynthia Bridges
Secretary

By

Danielle B. Clapinski
Attorney
Policy Services

This correspondence constitutes a private letter ruling (PLR) by the Louisiana Department of Revenue, as provided for by section 61:III.101 of the Louisiana Administrative Code. A PLR provides guidance to a specific taxpayer at the taxpayer's request. It is a written statement that applies principles of law to a specific set of facts or a particular tax situation. A PLR does not have the force and effect of law, and is not binding on the person who requested it or on any other taxpayer. This PLR is binding on the department only as to the taxpayer to whom it is addressed, and only if the facts presented were truthful and complete and the transaction was carried out as proposed. It continues as authority for the department's position unless a subsequent declaratory ruling, rule, court case, or statute supersedes it.