

BEFORE THE DEPARTMENT OF REVENUE  
OF THE STATE OF MONTANA

In the matter of the adoption of New )  
Rules I and II and the amendment of )  
ARM 42.9.107 and 42.15.120 )  
pertaining to the apportionment and )  
allocation of income reported by )  
pass-through entities and guaranteed )  
payments to individual partners )

TO: All Concerned Persons

1. On March 29, 2018, at 1 p.m., the Department of Revenue will hold a public hearing in the 3rd Floor Reception Conference Room of the Sam W. Mitchell Building, located at 125 North Roberts, Helena, Montana, to consider the proposed adoption and amendment of the above-stated rules. The hearing room is most readily accessed through the east doors of the building facing Sanders Street.

2. The Department of Revenue will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, contact the department no later than 5 p.m. on March 19, 2018, to advise us of the nature of the accommodation you need. Please contact Laurie Logan, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail lalogan@mt.gov.

3. The rules as proposed to be adopted provide as follows:

NEW RULE I APPORTIONABLE AND NONAPPORTIONABLE INCOME – APPORTIONMENT OR ALLOCATION – PASS-THROUGH ENTITIES (1) For purposes of the reporting requirements for pass-through entities that have Montana apportionable or nonapportionable income and determining their Montana source income and Montana tax liability, the department adopts by reference the following rules contained in ARM Title 42, chapter 26 - Corporate Multistate Activities, subchapters:

- (a) 1 - General Provisions;
- (b) 2 - Income Allocation and Apportionment, except ARM 42.26.204, 42.26.228, 42.26.229, and 42.26.260;
- (c) 4 - Special Rules Related to Installment Sales;
- (d) 6 - Railroads;
- (e) 7 - Trucking;
- (f) 8 - Airlines;
- (g) 9 - Special Rules for Construction Contracts;
- (h) 10 - Publishing Companies - Apportionment;
- (i) 11 - Television and Radio Broadcasting;
- (j) 12 - Telecommunication Services for Corporate Income Taxes; and

(k) 13 - Financial Institutions.

(2) The pass-through entity may petition for or the department may require an alternative method of reporting activity in the state as provided in 15-1-601, MCA.

(3) When applying the rules referred to in (1), the term "entity" replaces the term "corporation," and the provisions of Title 15, chapter 30, MCA, replace references to Title 15, chapter 31, MCA.

(4) The reporting requirements in ARM 42.9.107 are in addition to and not in lieu of any rules referred to in (1) and the provisions of the Multistate Tax Compact, as adopted in 15-1-601, MCA.

(5) A partnership whose operations are unitary with the business operations of a direct or indirect corporate partner and whose apportionment factors are included in the computation of that corporate partner's apportionment factors, pursuant to ARM 42.26.228, are considered a part of the corporate group for the purpose of applying the Finnigan Rule described in ARM 42.26.260.

AUTH: 15-30-2620, MCA

IMP: 15-1-601, 15-30-2111, 15-30-3302, 15-31-301, 15-31-305, MCA

REASON: The department proposes adopting New Rule I to provide for the apportionment and allocation of apportionable and nonapportionable income, within ARM Title 42, chapter 9, which contains rules specific to pass-through entities, to make this information easier for taxpayers to locate. The proposed rule is modelled after the language in ARM 42.15.120, which provides for the apportionment and allocation of apportionable and nonapportionable income as it pertains to individuals, estates, and trusts. That rule is also proposed to be amended in this same notice, including an update to the catchphrase of the rule to specifically identify who the rule pertains to.

The department's goal in proposing to adopt this new rule is to provide information pertaining to the apportionment and allocation of apportionable and nonapportionable income, as it pertains to pass-through entities, separately from ARM 42.15.120, for ease of locating when searching for specific reporting and filing requirements for pass-through entities, in general. The requirements, as they pertain to pass-through entities, are less transparent when located only in a chapter of rules that addresses individual income tax requirements.

Additionally, because the rules for pass-through entities are slightly different than the rules for individuals, estates, or trusts, the department believes having a separate but similar rule within each chapter will make the differences clearer. The language proposed for New Rule I is the same language as found in ARM 42.15.120, as proposed to be amended in this same notice, but without the references to taxpayers that are not pass-through entities.

The department proposes including the language in (5) to clarify that partnerships that are unitary with the business operations of a corporate partner are considered a part of the corporate group with respect to the application of the Finnigan Rule, provided in ARM 42.26.260. This means that a group of corporations engaged in a unitary business, as defined in 15-31-301, MCA, shall include Montana property, payroll, and receipts from all members of the unitary group if a unitary

partnership, whose interest is directly or indirectly held by a member of the corporate group, has nexus with Montana.

NEW RULE II GUARANTEED PAYMENTS TO INDIVIDUAL PARTNERS-SOURCING, APPORTIONMENT, AND ALLOCATION (1) Except as provided in (2) and (3), guaranteed payments made to individual partners pursuant to section 707 of the Internal Revenue Code, 26 U.S.C. 707, are sourced to Montana based upon the Montana apportionment factor of the partnership. For example:

(a) A nonresident taxpayer's federal adjusted gross income includes three hundred thousand dollars (\$300,000) of guaranteed payments for a designated use of capital received from a partnership that has a fifty percent (50%) Montana apportionment factor. One hundred and fifty thousand dollars (\$150,000) of the guaranteed payments are included in the partner's gross income from Montana sources based on the apportionment factor of the partnership.

(2) Guaranteed payments made to a retired partner, per 4 U.S.C., section 114(b)(1)(I), are sourced to the recipient's state of domicile.

(3) Guaranteed payments made to an individual partner as compensation for services are sourced to Montana if the services provided by the individual partner are performed in the state. For example:

(a) A nonresident taxpayer's federal adjusted gross income includes five thousand dollars (\$5,000) of guaranteed payments for services performed outside of Montana received from a partnership that has a fifty percent (50%) Montana apportionment factor. None of the guaranteed payments are included in the partner's gross income from Montana sources because the services were performed outside of Montana.

(b) A nonresident taxpayer's federal adjusted gross income includes five thousand dollars (\$5,000) of guaranteed payments for services performed in Montana received from a partnership that has a fifty percent (50%) Montana apportionment factor. All of the guaranteed payments are included in the partner's gross income from Montana sources because the services were performed in Montana.

AUTH: 15-30-2620, MCA

IMP: 15-30-2101, 15-30-2110, 15-30-3302, 15-30-3311, MCA

REASON: The department proposes adopting New Rule II to provide guidance on how guaranteed payments made to an individual partner are sourced to the state.

In general, guaranteed payments are regarded as a partner's distributive share of ordinary income for most purposes (see Treas. Reg. 1.707(c).) Logically, the portion of the income produced by the individual efforts of the partners should be treated, both to the partnership and to the individual partner, as compensation for services and it should be treated as income sourced in the state where the services were performed.

The remaining portion of each partner's income, attributable to partnership capital and the efforts of nonpartner employees, should logically be treated as a share of the profits from the partnership's business activities generally. This portion

should therefore be apportioned according to the partnership's property, payroll, and sales factors.

4. The rules as proposed to be amended provide as follows, new matter underlined, deleted matter interlined:

42.9.107 MULTI-TIERED PASS-THROUGH ENTITY STRUCTURES WITH MONTANA SOURCE INCOME – REPORTING REQUIREMENTS (1) A pass-through entity may have, in addition to income from its own operations or activities, income from one or more other pass-through entities. This rule describes how the pass-through entity must classify its income from its own operations or activities as ~~business or nonbusiness~~ apportionable or nonapportionable income and how it must report its income from other pass-through entities. For purposes of this rule, "operations income" means the income of a pass-through entity from its own operations or activities and "flow-through income" means its separately and nonseparately stated distributable share of income from other pass-through entities.

(2) Except as provided in (5), each pass-through entity has to separately determine whether its operations income is ~~business or nonbusiness~~ apportionable or nonapportionable income as those terms are defined in ARM 42.26.206. Once a pass-through entity determines the ~~business or nonbusiness~~ apportionable or nonapportionable character of its operations income, the entity must then determine what part of this ~~business and/or nonbusiness~~ apportionable and/or nonapportionable income is Montana source income. Except as provided in (5) and (6), the operations income retains its character as ~~business or nonbusiness~~ apportionable or nonapportionable income and as Montana source income regardless of how many other tiers of pass-through entities through which the income is passed.

(3) Except as provided in (5) and (6), flow-through income of a pass-through entity, determined as provided in (1), retains its character as ~~business and/or nonbusiness~~ apportionable and/or nonapportionable income and its character as Montana source income.

(4) An entity in a multi-tiered pass-through entity structure may have flow-through income sourced to Montana under the subsections of the definition of "Montana source income" in 15-30-2101, MCA, that address partnership or S corporation income derived from Montana activity or property, reportable on Montana Schedule K-1, and also operations income sourced to Montana as a result of its own business activity under other subsections of that definition of "Montana source income," such as net income from a business, profession, or farming activities carried on in the state. If this occurs the entity must allocate to Montana the flow-through income sourced to Montana and the entity must determine the portion of its operations income that is sourced to Montana as provided in (1) and allocate or apportion that Montana source income under the provisions of ~~ARM 42.15.120~~ [NEW RULE I].

(5) remains the same.

(6) Nothing in this rule prevents the department from determining the ~~business or nonbusiness~~ apportionable or nonapportionable character of an entity's

operations income or the Montana source character of its Montana flow-through income sourced to Montana.

AUTH: 15-1-201, MCA

IMP: 15-1-601, 15-30-3302, 15-30-3311, 15-31-301, MCA

REASON: The department proposes amending ARM 42.9.107 to update the reference in (4) from ARM 42.15.120 to New Rule I. This will capture a change being proposed by the department in this same notice to adopt the new rule and place it in ARM Title 42, chapter 9, which specifically covers rules pertaining to pass-through entities. As proposed to be adopted, New Rule I is essentially the same rule as ARM 42.15.120; however, it will specifically apply to pass-through entities.

The department also proposes amending the rule to implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms, where applicable, to align the rule with the revised statute.

42.15.120 BUSINESS AND NONBUSINESS APPORTIONABLE AND NONAPPORTIONABLE INCOME - APPORTIONMENT OR ALLOCATION - INDIVIDUALS, ESTATES, AND TRUSTS (1) For purposes of the reporting requirements for individuals, trusts, and estates, and pass-through entities that have Montana business or nonbusiness apportionable or nonapportionable income and determining their Montana tax liability, the department adopts by reference the following rules contained in ARM Title 42, chapter 26 – Corporate Multistate Activities subchapters:

- (a) 1 - General Provisions, ~~as it existed on December 21, 2001;~~
- (b) 2 - Income Allocation and Apportionment, ~~as they existed on December 27, 2002,~~ except ARM 42.26.204, 42.26.228, and 42.26.229, and 42.26.260;
- (c) 4 - Special Rules Related to Installment Sales, ~~as they existed on December 21, 2001;~~
- (d) 6 - Railroads, ~~as they existed on December 21, 2001;~~
- (e) 7 - Trucking, ~~as they existed on December 21, 2001;~~
- (f) 8 - Airlines, ~~as they existed on December 21, 2001;~~
- (g) 9 - Special Rules for Construction Contracts, ~~as they existed on December 21, 2001;~~
- (h) 10 - Publishing Companies - Apportionment, ~~as they existed on April 23, 2004; and;~~
- (i) 11 - Television and Radio Broadcasting, ~~as they existed on April 23, 2004;~~
- (j) 12 – Telecommunication Services for Corporate Income Taxes; and
- (k) 13 - Financial Institutions.

(2) remains the same.

(3) When applying the rules referred to in (1), the terms "individual," "trust," or "estate," ~~or "entity"~~ replace the term "corporation," and the provisions of Title 15, chapter 30, MCA, replace references to Title 15, chapter 31, MCA.

~~(4) The reporting requirements in ARM 42.9.107 are in addition to and not in lieu of any rules referred to in (1) and the provisions of the Multistate Tax Compact as adopted in 15-1-601, MCA.~~

AUTH: 15-30-2620, MCA

IMP: 15-1-601, 15-30-2111, MCA

REASON: The department proposes amending ARM 42.15.120 to remove references to pass-through entities from the rule, because the department is proposing to adopt a separate but similar rule, in this same notice, that pertains specifically to pass-through entities. When adopted, the new rule will be located in ARM Title 42, chapter 9, Pass-Through Entities.

Because the requirements for pass-through entities are slightly different than the requirements for individuals, estates, or trusts, the department believes providing two separate rules will make these differences clearer and easier for taxpayers to locate within the applicable chapters of ARM Title 42.

Since this rule was last amended, some of the ARM Title 42, chapter 26 rules referenced in (1) have been revised. Therefore, the department proposes removing the term "as they existed on" and the specific references to dates from the rule after determining that this language is unnecessary and potentially results in an inconsistent application of the apportionment rules between pass-through entities and corporations when the intention is to maintain consistency. The department is including recently adopted ARM 42.26.260, as an exception to the ARM Title 42, chapter 26, subchapter 2 rules referenced under (1)(b), because it is a rule that only applies to the corporate tax filing of a combined unitary group. The department also proposes adding a reference to subchapter 12, as (1)(j), to include new rules that have been added to ARM Title 42, chapter 26. The department further proposes adding a reference to new subchapter 13, as (1)(k), to include three recently adopted rules specific to financial institutions, ARM 42.26.1301, 42.26.1302, and 42.26.1303.

The department proposes eliminating the language in (4), because it is specific to the filing requirements of multi-tier pass-through entities with sourcing rules from these entities. Accordingly, the department proposes relocating this same language to its proposed New Rule I in this notice. With the enactment of the new, similar rule specific to pass-through entities, this language no longer needs to remain in this rule pertaining to individuals, estates, and trusts.

The department further proposes amending the rule to implement House Bill 511, L. 2017, which changed the term "business income" to "apportionable income," and the term "nonbusiness income" to "nonapportionable income." The department proposes striking the old terms and replacing them with the new terms where applicable in the rule and also in the catchphrase. The department also proposes adding the words "individuals, estates, and trusts" to the catchphrase to better reflect the content of the rule as amended.

5. Concerned persons may submit their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to: Laurie Logan, Department of Revenue, Director's Office, P.O. Box

7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail [lalogan@mt.gov](mailto:lalogan@mt.gov) and must be received no later than April 11, 2018.

6. Laurie Logan, Department of Revenue, Director's Office, has been designated to preside over and conduct this hearing.

7. The Department of Revenue maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this agency. Persons who wish to have their name added to the list shall make a written request that includes the name and e-mail or mailing address of the person to receive notices and specifies that the person wishes to receive notice regarding a subject matter or matters. Notices will be sent by e-mail unless a mailing preference is noted in the request. A written request may be mailed or delivered to the person in 5 above or faxed to the office at (406) 444-3696, or may be made by completing a request form at any rules hearing held by the Department of Revenue.

8. An electronic copy of this notice is available on the department's web site [revenue.mt.gov](http://revenue.mt.gov), or on the Secretary of State's web site [sos.mt.gov/ARM/register](http://sos.mt.gov/ARM/register).

9. The bill sponsor contact requirements of 2-4-302, MCA, apply and have been fulfilled. The primary sponsor of House Bill 511, Representative Rob Cook, was contacted by regular mail on June 14, 2017, and September 22, 2017.

10. Regarding the requirements of 2-4-111, MCA, the department has determined that the adoption and amendment of the above-referenced rules will not significantly and directly impact small businesses. Documentation of this determination is available at [revenue.mt.gov](http://revenue.mt.gov) or upon request from the person in 5.

/s/ Laurie Logan  
Laurie Logan  
Rule Reviewer

/s/ Mike Kadas  
Mike Kadas  
Director of Revenue

Certified to the Secretary of State February 13, 2018.