

SENATE BILL NO. 121
INTRODUCED BY GLASER
BY REQUEST OF THE DEPARTMENT OF REVENUE

A BILL FOR AN ACT ENTITLED: "AN ACT GENERALLY REVISING THE TAXATION OF PASS-THROUGH ENTITIES AND THEIR OWNERS; TO CLARIFY THAT ALL OWNERS OF PASS-THROUGH ENTITIES WITH MONTANA SOURCE INCOME ARE SUBJECT TO TAX; TO EXTEND THE CONSENT, COMPOSITE RETURN, AND WITHHOLDING PROVISIONS TO FOREIGN C. CORPORATIONS AND TO OTHER PASS-THROUGH ENTITY OWNERS; TO PROVIDE A REFUNDABLE CREDIT FOR SECOND-TIER PASS-THROUGH ENTITY OWNERS FOR WITHHELD AMOUNTS REMITTED ON THEIR BEHALF; TO CLARIFY AN INTENT THAT THE PASS-THROUGH ENTITY PROVISIONS NOT OVERRIDE THE MULTISTATE TAX COMPACT; PROVIDING A DEFINITION OF "FOREIGN C. CORPORATION"; AND AMENDING SECTIONS 15-30-101, 15-30-1102, 15-30-1112, AND 15-30-1113, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

SECTION 1. SECTION 15-30-101, MCA, IS AMENDED TO READ:

"15-30-101. Definitions. For the purpose of this chapter, unless otherwise required by the context, the following definitions apply:

- (1) "Base year structure" means the following elements of the income tax structure:
 - (a) the tax brackets established in 15-30-103, but unadjusted by 15-30-103(2), in effect on June 30 of the taxable year;
 - (b) the exemptions contained in 15-30-112, but unadjusted by 15-30-112(6), in effect on June 30 of the taxable year;
 - (c) the maximum standard deduction provided in 15-30-122, but unadjusted by 15-30-122(2), in effect on June 30 of the taxable year.
- (2) "Consumer price index" means the consumer price index, United States city average, for all items, using the 1967 base of 100 as published by the bureau of labor statistics of the U.S. department of labor.
- (3) "Corporation" or "C. corporation" means a corporation, limited liability company, or other entity:
 - (a) that is treated as an association for federal income tax purposes;
 - (b) for which a valid election under section 1362 of the Internal Revenue Code (26 U.S.C. 1362) is not

in effect; and

(c) that is not a disregarded entity.

(4) "Department" means the department of revenue.

(5) "Disregarded entity" means a business entity:

(a) that is disregarded as an entity separate from its owner for federal tax purposes, as provided in United States treasury regulations 301.7701-2 or 301.7701-3, 26 CFR 301.7701-2 or 26 CFR 301.7701-3, or as those regulations may be labeled or amended; or

(b) that is a qualified subchapter S. subsidiary that is not treated as a separate corporation, as provided in section 1361(b)(3) of the Internal Revenue Code (26 U.S.C. 1361(b)(3)).

(6) "Dividend" means:

(a) any distribution made by a C. corporation out of its earnings and profits to its shareholders or members, whether in cash or in other property or in stock of the corporation, other than stock dividends; and

(b) any distribution made by an S. corporation treated as a dividend for federal income tax purposes.

(7) "Fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, trust, or estate.

(8) "Foreign C. corporation" means a corporation that is not engaged in or doing business in Montana, as provided in 15-31-101.

~~(8)(9)~~ "Foreign government" means any jurisdiction other than the one embraced within the United States, its territories, and its possessions.

~~(9)(10)~~ "Gross income" means the taxpayer's gross income for federal income tax purposes as defined in section 61 of the Internal Revenue Code (26 U.S.C. 61) or as that section may be labeled or amended, excluding unemployment compensation included in federal gross income under the provisions of section 85 of the Internal Revenue Code (26 U.S.C. 85) as amended.

~~(10)(11)~~ "Inflation factor" means a number determined for each tax year by dividing the consumer price index for June of the tax year by the consumer price index for June 1980.

~~(11)(12)~~ "Information agents" includes all individuals and entities acting in whatever capacity, including lessees or mortgagors of real or personal property, fiduciaries, brokers, real estate brokers, employers, and all officers and employees of the state or of any municipal corporation or political subdivision of the state, having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income with respect to which any person or fiduciary is taxable under this chapter.

~~(12)~~(13) "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended, or as it may be labeled or further amended. References to specific provisions of the Internal Revenue Code mean those provisions as they may be otherwise labeled or further amended.

~~(13)~~(14) "Knowingly" is as defined in 45-2-101.

~~(14)~~(15) "Limited liability company" means a limited liability company, domestic limited liability company, or a foreign limited liability company as defined in 35-8-102.

~~(15)~~(16) "Limited liability partnership" means a limited liability partnership as defined in 35-10-102.

~~(16)~~(17) "Lottery winnings" means income paid either in lump sum or in periodic payments to:

- (a) a resident taxpayer on a lottery ticket; or
- (b) a nonresident taxpayer on a lottery ticket purchased in Montana.

~~(17)~~(18) (a) "Montana source income" means:

(i) wages, salary, tips, and other compensation for services performed in the state or while a resident of the state;

(ii) gain attributable to the sale or other transfer of tangible property located in the state, sold or otherwise transferred while a resident of the state, or used or held in connection with a trade, business, or occupation carried on in the state;

(iii) gain attributable to the sale or other transfer of intangible property received or accrued while a resident of the state;

(iv) interest received or accrued while a resident of the state or from an installment sale of real property or tangible commercial or business personal property located in the state;

(v) dividends received or accrued while a resident of the state;

(vi) net income or loss derived from a trade, business, profession, or occupation carried on in the state or while a resident of the state;

(vii) net income or loss derived from farming activities carried on in the state or while a resident of the state;

(viii) net rents from real property and tangible personal property located in the state or received or accrued while a resident of the state;

(ix) net royalties from real property and from tangible real property to the extent the property is used in the state or the net royalties are received or accrued while a resident of the state. The extent of use in the state is determined by multiplying the royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the royalty period in the tax year and the denominator of which is the

number of days of physical location of the property everywhere during all royalty periods in the tax year. If the physical location is unknown or unascertainable by the taxpayer, the property is considered used in the state in which it was located at the time the person paying the royalty obtained possession.

(x) patent royalties to the extent the person paying them employs the patent in production, fabrication, manufacturing, or other processing in the state, a patented product is produced in the state, or the royalties are received or accrued while a resident of the state;

(xi) net copyright royalties to the extent printing or other publication originates in the state or the royalties are received or accrued while a resident of the state;

(xii) partnership income, gain, loss, deduction, or credit or item of income, gain, loss, deduction, or credit:

(A) derived from a trade, business, occupation, or profession carried on in the state;

(B) derived from the sale or other transfer or the rental, lease, or other commercial exploitation of property located in the state; or

(C) taken into account while a resident of the state;

(xiii) an S. corporation's separately and nonseparately stated income, gain, loss, deduction, or credit or item of income, gain, loss, deduction, or credit:

(A) derived from a trade, business, occupation, or profession carried on in the state;

(B) derived from the sale or other transfer or the rental, lease, or other commercial exploitation of property located in the state; or

(C) taken into account while a resident of the state;

(xiv) social security benefits received or accrued while a resident of the state;

(xv) taxable individual retirement account distributions, annuities, pensions, and other retirement benefits received while a resident of the state; and

(xvi) any other income attributable to the state, including but not limited to lottery winnings, state and federal tax refunds, nonemployee compensation, recapture of tax benefits, and capital loss addbacks.

(b) The term does not include:

(i) compensation for military service of members of the armed services of the United States who are not Montana residents and who are residing in Montana solely by reason of compliance with military orders and does not include income derived from their personal property located in the state except with respect to personal property used in or arising from a trade or business carried on in Montana; or

(ii) interest paid on loans held by out-of-state financial institutions recognized as such in the state of their domicile, secured by mortgages, trust indentures, or other security interests on real or personal property located

in the state, if the loan is originated by a lender doing business in Montana and assigned out-of-state and there is no activity conducted by the out-of-state lender in Montana except periodic inspection of the security.

~~(18)~~(19) "Net income" means the adjusted gross income of a taxpayer less the deductions allowed by this chapter.

~~(19)~~(20) "Nonresident" means a natural person who is not a resident.

~~(20)~~(21) "Paid", for the purposes of the deductions and credits under this chapter, means paid or accrued or paid or incurred, and the terms "paid or accrued" and "paid or incurred" must be construed according to the method of accounting upon the basis of which the taxable income is computed under this chapter.

~~(21)~~(22) "Partner" means a member of a partnership or a manager or member of any other entity, if treated as a partner for federal income tax purposes.

~~(22)~~(23) "Partnership" means a general or limited partnership, limited liability partnership, limited liability company, or other entity, if treated as a partnership for federal income tax purposes.

~~(23)~~(24) "Pass-through entity" means a partnership, an S. corporation, or a disregarded entity.

~~(24)~~(25) "Pension and annuity income" means:

(a) systematic payments of a definitely determinable amount from a qualified pension plan, as that term is used in section 401 of the Internal Revenue Code (26 U.S.C. 401), or systematic payments received as the result of contributions made to a qualified pension plan that are paid to the recipient or recipient's beneficiary upon the cessation of employment;

(b) payments received as the result of past service and cessation of employment in the uniformed services of the United States;

(c) lump-sum distributions from pension or profit-sharing plans to the extent that the distributions are included in federal adjusted gross income;

(d) distributions from individual retirement, deferred compensation, and self-employed retirement plans recognized under sections 401 through 408 of the Internal Revenue Code (26 U.S.C. 401 through 408) to the extent that the distributions are not considered to be premature distributions for federal income tax purposes; or

(e) amounts received from fully matured, privately purchased annuity contracts after cessation of regular employment.

~~(25)~~(26) "Purposely" is as defined in 45-2-101.

~~(26)~~(27) "Received", for the purpose of computation of taxable income under this chapter, means received or accrued, and the term "received or accrued" must be construed according to the method of accounting upon the basis of which the taxable income is computed under this chapter.

~~(27)~~(28) "Resident" applies only to natural persons and includes, for the purpose of determining liability to the tax imposed by this chapter with reference to the income of any taxable year, any person domiciled in the state of Montana and any other person who maintains a permanent place of abode within the state even though temporarily absent from the state and who has not established a residence elsewhere.

~~(28)~~(29) "S. corporation" means an incorporated entity for which a valid election under section 1362 of the Internal Revenue Code (26 U.S.C. 1362) is in effect.

~~(29)~~(30) "Stock dividends" means new stock issued, for surplus or profits capitalized, to shareholders in proportion to their previous holdings.

~~(30)~~(31) "Taxable income" means the adjusted gross income of a taxpayer less the deductions and exemptions provided for in this chapter.

~~(31)~~(32) "Taxable year" or "tax year" means the taxpayer's taxable year for federal income tax purposes.

~~(32)~~(33) "Taxpayer" includes any person, entity, or fiduciary, resident or nonresident, subject to a tax or other obligation imposed by this chapter and unless otherwise specifically provided does not include a C. corporation."

Section 2. Section 15-30-1102, MCA, is amended to read:

"15-30-1102. Income or license tax involving pass-through entities -- information returns required.

(1) Except as otherwise provided:

- (a) a partnership is not subject to taxes imposed in Title 15, chapter 30 or 31;
- (b) an S. corporation is not subject to the taxes imposed in Title 15, chapter 30 or 31; and
- (c) a disregarded entity is not subject to the taxes imposed in Title 15, chapter 30 or 31.

(2) Except as otherwise provided, each partner of a partnership described in subsection (1)(a), each shareholder of an S. corporation described in subsection (1)(b), and each partner, shareholder, ~~manager~~, member, or other owner of an entity described in subsection (1)(c), THE FIRST-TIER PASS-THROUGH ENTITY, is subject to the taxes provided in this chapter, if an individual, trust, or estate, and to the taxes provided in Title 15, chapter 31, if a C. corporation. If a partner, shareholder, member, or other owner of an entity described in subsection (1) is ITSELF a pass-through entity, any individual, trust, or estate to which THE FIRST-TIER PASS-THROUGH ENTITY'S Montana source income is directly or indirectly passed through is subject to the taxes provided in this chapter and any C. corporation to which THE FIRST-TIER PASS-THROUGH ENTITY'S Montana source income is directly or indirectly passed through is subject to the taxes provided in Title 15, chapter 31.

(3) Income realized for federal income tax purposes by a financial institution that has elected to be

treated as an S. corporation under subchapter S. of Chapter 1 of the Internal Revenue Code and by its shareholders that is attributable to the financial institution's change from the bad debt reserve method of accounting provided in section 585 of the Internal Revenue Code, 26 U.S.C. 585, is not taxable under Title 15, chapter 30 or 31, to the extent that the aggregate deductions allowed for federal income tax purposes under 26 U.S.C. 585 exceeded the aggregate deductions that the financial institution is allowed under 15-31-114(1)(b)(i).

(4) (a) A partnership that has Montana source income shall on or before the 15th day of the 4th month following the close of its annual accounting period file an information return on forms prescribed by the department and a copy of its federal partnership return. The return must include:

- (i) the name, address, and social security or federal identification number of each partner;
- (ii) the partnership's Montana source income;
- (iii) each partner's distributive share of Montana source income, gain, loss, deduction, or credit or item of income, gain, loss, deduction, or credit;
- (iv) each partner's distributive share of income, gain, loss, deduction, or credit or item of income, gain, loss, deduction, or credit from all sources; and
- (v) any other information the department prescribes.

(b) An S. corporation that has Montana source income shall on or before the 15th day of the 3rd month following the close of its annual accounting period file an information return on forms prescribed by the department and a copy of its federal S. corporation return. The return must include:

- (i) the name, address, and social security or federal identification number of each shareholder;
- (ii) the S. corporation's Montana source income and each shareholder's pro rata share of separately and nonseparately stated Montana source income, gain, loss, deduction, or credit or item of income, gain, loss, deduction, or credit;
- (iii) each shareholder's pro rata share of separately and nonseparately stated income, gain, loss, deduction, or credit or item of income, gain, loss, deduction, or credit from all sources; and
- (iv) any other information the department prescribes.

(c) A disregarded entity that has Montana source income shall furnish the information and file the returns the department prescribes. The return must include:

- (i) the name, address, and social security or federal identification number of each ~~manager~~, member, or other owner during the tax year;
- (ii) the entity's Montana source income; and
- (iii) any other information the department prescribes.

(d) (i) Except as provided in subsection (4)(d)(ii), a pass-through entity that fails to file an information return required by this section by the due date, including any extension, must be assessed a late filing penalty of \$10 multiplied by the number of the entity's partners, shareholders, ~~managers~~, members, or other owners at the close of the tax year for each month or fraction of a month, not to exceed 5 months, that the entity fails to file the information return. The department may waive the penalty imposed by this subsection (4)(d)(i) as provided in 15-1-206.

(ii) The penalty imposed under subsection (4)(d)(i) may not be imposed on a pass-through entity that has 10 or fewer partners, shareholders, ~~managers~~, members, or other owners, each of whom:

(A) is an individual, an estate of a deceased individual, or a C. corporation;

(B) has filed any required return or other report with the department by the due date, including any extension of time, for the return or report; and

(C) has paid all taxes when due."

Section 3. Section 15-30-1112, MCA, is amended to read:

"15-30-1112. Composite returns and tax. (1) A partnership or S. corporation may elect to file a composite return and pay a composite tax on behalf of participants. A participant is a partner, shareholder, ~~manager, or member, or other owner~~ who:

(a) is a nonresident individual, a FOREIGN C. corporation, or a pass-through entity whose only Montana source income for the tax year is from the entity and other partnerships or S. corporations electing to file the composite return and pay the composite tax on behalf of that partner, shareholder, ~~manager, or member, or other owner~~; and

(b) consents to be included in the filing.

(2) (a) Each participant's composite tax liability is the product obtained by:

(i) determining the tax that would be imposed, using the rates specified in 15-30-103, on the sum obtained by subtracting the allowable standard deduction for a single individual and one exemption allowance from the participant's share of the entity's income from all sources as determined for federal income tax purposes; and

(ii) multiplying that amount by the ratio of the entity's Montana source income to the entity's income from all sources for federal income tax purposes.

(b) A participant's share of the entity's income is the aggregate of the participant's share of the entity's income, gain, loss, or deduction or item of income, gain, loss, or deduction.

- (3) The composite tax is the sum of each participant's composite tax liability.
- (4) The electing entity:
- (a) shall remit the composite tax to the department;
 - (b) must be responsible for any assessments of additional tax, penalties, and interest, which additional assessments must be based on the total liability reflected in the composite return;
 - (c) shall represent the participants in any appeals, claims for refund, hearing, or court proceeding in any matters relating to the filing of the composite return;
 - (d) shall make quarterly estimated tax payments as prescribed by 15-30-241 computed separately for each participant included in the filing of a composite return; and
 - (e) shall retain powers of attorney executed by each participant included in the composite return, authorizing the entity to file the composite return and to act on behalf of each participant.
- (5) The composite return must be made on forms the department prescribes and filed on or before the due date, including extensions, for filing the entity information return. The composite return is in lieu of an individual income tax return required under 15-30-142 and 15-30-144, A CORPORATION LICENSE TAX RETURN REQUIRED UNDER 15-31-111, AND A CORPORATION INCOME TAX RETURN REQUIRED UNDER 15-31-403.
- (6) The composite tax is in lieu of the ~~tax~~ taxes imposed under:
- (a) 15-30-103 and 15-30-105;
 - (b) 15-31-101 and 15-31-121; and
 - (c) 15-31-403.
- (7) The department may adopt rules that are necessary to implement and administer this section."

Section 4. Section 15-30-1113, MCA, is amended to read:

"15-30-1113. Consent or withholding. (1) A pass-through entity that is required to file an information return as provided in 15-30-1102 and that has a partner, shareholder, ~~manager~~, member, or other owner who is a nonresident individual, a FOREIGN C. corporation, or a pass-through entity that ITSELF has any partner, shareholder, member, or other owner that is a nonresident individual, FOREIGN C. corporation, or pass-through entity shall, on or before the due date, including extensions, for the information return:

- (a) with respect to any partner, shareholder, member, or other owner who is a nonresident individual:
 - (i) file a composite return ~~with respect to the individual nonresident;~~
 - ~~(b)~~(ii) file an agreement of the individual nonresident to:
 - ~~(i)~~(A) file a return in accordance with the provisions of 15-30-142;

- ~~(ii)(B)~~ timely pay all taxes imposed with respect to income of the pass-through entity; and
- ~~(iii)(C)~~ be subject to the personal jurisdiction of the state for the collection of income taxes and related interest, penalties, and fees imposed with respect to the income of the pass-through entity; or
- ~~(e)(iii)~~ remit an amount equal to the highest marginal tax rate in effect under 15-30-103 multiplied by the nonresident individual's share of Montana source income reflected on the pass-through entity's information return;
- (b) with respect to any partner, shareholder, member, or other owner that is a FOREIGN C. corporation:
- (i) file a composite return;
- (ii) file the FOREIGN C. corporation's agreement to:
- (A) file a return in accordance with the provisions of 15-31-111;
- (B) timely pay all taxes imposed with respect to income of the pass-through entity; and
- (C) be subject to the personal jurisdiction of the state for the collection of corporation license and income taxes and related interest, penalties, and fees imposed with respect to the income of the pass-through entity; or
- (iii) remit an amount equal to the tax rate in effect under 15-31-121 multiplied by the FOREIGN C. corporation's share of Montana source income reflected on the pass-through entity's information return; and
- (c) with respect to any partner, shareholder, member, or other owner that is a pass-through entity, also referred to in this section as a "second-tier pass-through entity":
- (i) file a composite return;
- (ii) file a statement of the pass-through entity partner, shareholder, or other owner setting forth the name, address, and social security or federal identification number of each of that entity's partners, shareholders, members, or other owners and information that establishes that its share of Montana source income is WILL BE fully accounted in individual income or corporation license or income tax returns filed with the state; or
- (iii) remit an amount equal to the highest marginal tax rate in effect under 15-30-103 multiplied by its share of Montana source income reflected on the pass-through entity's information return.
- (2) Any amount paid by a pass-through entity with respect to a nonresident individual pursuant to subsection ~~(1)(c)~~ (1)(a)(iii) must be considered as a payment on the account of the nonresident individual for the income tax imposed on the nonresident individual for the tax year pursuant to 15-30-105. On or before the due date, including extensions, of the pass-through entity's information return provided in 15-30-1102, the pass-through entity shall furnish to the nonresident individual a record of the amount of tax paid on the individual's behalf.
- (3) Any amount paid by a pass-through entity with respect to a FOREIGN C. corporation pursuant to subsection (1)(b)(iii) must be considered as a payment on the account of the FOREIGN C. corporation for the

corporation license tax imposed on the FOREIGN C. corporation for the tax year pursuant to 15-31-101 or the corporation income tax imposed on the FOREIGN C. corporation for the tax year pursuant to 15-31-403. On or before the due date, including extensions, of the pass-through entity's information return provided in 15-30-1102, the pass-through entity shall furnish to the FOREIGN C. corporation a record of the amount of tax paid on its behalf.

(4) Any amount paid by a pass-through entity with respect to a second-tier pass-through entity pursuant to subsection (1)(c)(iii) must be considered as payment on the account of the individual, trust, estate, or C. corporation to which Montana source income is directly or indirectly passed through and must be claimed as the distributable share of a refundable credit of the pass-through entity partner, shareholder, member, or other owner on behalf of which the amount was paid. On or before the due date, including extensions, of the pass-through entity's information return provided in 15-30-1102, the pass-through entity shall furnish to the second-tier pass-through entity a record of the refundable credit that may be claimed for the amount paid on its behalf.

(5) A pass-through entity is entitled to recover a payment made pursuant to ~~subsection (1)(c)~~ subsection (1)(a)(iii), (1)(b)(iii), or (1)(c)(iii) from the partner, shareholder, ~~manager~~, member, or other owner on whose behalf the payment was made.

(6) Following the department's notice to a pass-through entity that a nonresident individual or FOREIGN C. corporation did not file a return or timely pay all taxes as provided in subsection (1), the pass-through entity must, with respect to any tax year thereafter for which the nonresident individual or FOREIGN C. corporation is not included in the pass-through entity's composite return, remit the amount described in subsection (1)(a)(iii) for the nonresident individual and the amount described in subsection (1)(b)(iii) for the FOREIGN C. corporation.

(7) Nothing in this section may be construed as modifying the provisions of Article IV, section 18, of 15-1-601 and 15-31-312 allowing a taxpayer to petition for and the department to require methods to fairly represent the extent of the taxpayer's business activity in the state."

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