

**Fifty-seventh Legislative Assembly of North Dakota
In Regular Session Commencing Tuesday, January 9, 2001**

HOUSE BILL NO. 1065
(Finance and Taxation Committee)
(At the request of the Tax Commissioner)

AN ACT to create and enact section 57-38-08.1 of the North Dakota Century Code, relating to the allocation and apportionment of partnership income for income tax purposes; to amend and reenact subsections 4, 5, and 6 of section 57-38-04 and section 57-38-08 of the North Dakota Century Code, relating to the allocation and apportionment of an individual's gross income and the distribution of partnership income for income tax purposes; to repeal section 57-38-10 of the North Dakota Century Code, relating to allocation and apportionment of partnership income for income tax purposes; and to provide an effective date.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. AMENDMENT. Subsections 4, 5, and 6 of section 57-38-04 of the North Dakota Century Code are amended and reenacted as follows:

4. Income derived from ~~carrying on a trade or business activity~~ carried on by an individual as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity must be assigned to this state without regard to the residence of the individual if the ~~trade or business activity~~ is conducted wholly within this state. Income derived from gaming activity carried on in this state by an individual must be assigned to this state without regard to the residence of the individual.
5. Whenever ~~a trade or business activity~~ is carried on partly within and partly without this state by a nonresident of this state; as a sole proprietorship, or through a partnership, subchapter S corporation, or other passthrough entity, the entire income therefrom must be allocated to this state and to other states, according to the provisions of chapter 57-38.1, providing for allocation and apportionment of income of corporations doing business within and without this state.
6.
 - a. Income and gains received by a resident of this state from tangible property not employed in the business and from tangible property employed in the business of the taxpayer, if ~~such the~~ business consists principally of the holding of ~~such the~~ property and the collection of income and gains therefrom, must be assigned to this state without regard to the situs of ~~such the~~ property.
 - b. Income derived from ~~carrying on a trade or business activity~~ carried on by residents of this state, whether the business activity is conducted as a sole proprietorship, or through a partnership, subchapter S corporation or other passthrough entity, must be assigned to this state without regard to where ~~such trade or the business activity~~ is conducted, and the provisions of chapter 57-38.1 do not apply. If the taxpayer believes the operation of this subdivision with respect to the taxpayer's income is unjust, the taxpayer may petition the tax commissioner who may allow use of another method of reporting income, including separate accounting.
 - c. If a tax is paid to another state or territory of the United States or to the District of Columbia on any income assigned to this state under this subsection, a credit for any tax so paid may be deducted from the tax assessed under this chapter if written proof of ~~such the~~ payment is furnished to the tax commissioner; provided, that this credit for ~~such the~~ tax may not exceed the proportion of the tax otherwise due under this chapter that the amount of the taxpayer's adjusted gross income derived from sources in the other taxing jurisdiction bears to the taxpayer's adjusted gross income as computed pursuant to the Internal Revenue Code of 1954, as amended.

SECTION 2. AMENDMENT. Section 57-38-08 of the North Dakota Century Code is amended and reenacted as follows:

57-38-08. Partnerships not subject to tax. Partnerships are not subject to tax under this chapter. Persons carrying on a business as partners are taxable on their share of the net profits of a partnership whether the same are distributed or not and are entitled to deduct their share of any net losses suffered by the partnership respective shares of the partnership's income, gain, loss, and deduction included in the partner's federal taxable income, as provided under section 57-38-08.1.

SECTION 3. Section 57-38-08.1 of the North Dakota Century Code is created and enacted as follows:

57-38-08.1. Allocation and apportionment of partnership income - Taxation of partners.

1. A partnership that carries on its business activity entirely within this state shall report all of its income or loss to this state. A partnership that carries on its business activity within and without this state shall allocate and apportion its income or loss to this state in the same manner as the income or loss of a corporation is allocated and apportioned to the state under chapter 57-38.1.
2. Resident partners, limited to individuals, estates, and trusts, must report their entire distributive share to this state as provided in subdivision b of subsection 6 of section 57-38-04, and may claim a credit for taxes paid to another state on that portion of their distributive share attributable to and taxed by another state, as provided in subdivision c of subsection 6 of section 57-38-04.
3.
 - a. In determining the gross income of a nonresident partner, limited to individuals, estates, and trusts, there must be included only that part derived from or connected with sources in this state of the partner's distributive share of items of partnership income, gain, loss and deduction, or item thereof, entering into the federal taxable income of the partner, as determined under section 57-38-04. Except as otherwise provided in this subdivision, guaranteed payments paid to nonresident partners of a partnership that has business activity in this state are treated as a distributive share of partnership income for state tax purposes. In the case of a professional service partnership, the portion of a guaranteed payment paid to a nonresident partner attributable to a reasonable salary may not be treated as a distributive share. The portion of the guaranteed payment not treated as a distributive share that is for services performed in this state must be assigned as provided under subsection 1 of section 57-38-04. For purposes of this subdivision, "professional service partnership" means a partnership that engages in the practice of law, accounting, medicine, and any other profession in which neither capital nor the services of employees are a material income producing factor.
 - b. In determining the sources of a nonresident partner's income, no effect shall be given to a provision in the partnership agreement which:
 - (1) Characterizes payments to the partners as being for services or for the use of capital or allocates to the partner, as income or gain from sources outside this state, a greater proportion of the partner's distributive share of partnership income or gain than the ratio of partnership income or gain from sources outside this state to partnership income or gain from all sources, except as authorized in subdivision d; or
 - (2) Allocates to the partner a greater proportion of a partnership item of loss or deduction connected with sources in this state than the proportionate share of the partner, for federal income tax purposes, of partnership loss or deduction generally, except as authorized in subdivision d.
 - c. Any modification to federal taxable income described in this chapter that relates to an item of partnership income, gain, loss, or deduction, or item thereof, must be made in

accordance with the partner's distributive share, for federal income tax purposes, of the item to which the modification relates, but limited to the partner's portion of the item derived from or connected with sources in this state.

- d. On application, the commissioner may authorize the use of other methods of determining a nonresident partner's portion of partnership items derived from or connected with sources in this state, and the related modifications, as may be appropriate and equitable, on the terms and conditions as it may require.

SECTION 4. REPEAL. Section 57-38-10 of the North Dakota Century Code is repealed.

SECTION 5. EFFECTIVE DATE. This Act is effective for taxable years beginning after December 31, 2000.

Speaker of the House

President of the Senate

Chief Clerk of the House

Secretary of the Senate

This certifies that the within bill originated in the House of Representatives of the Fifty-seventh Legislative Assembly of North Dakota and is known on the records of that body as House Bill No. 1065.

House Vote: Yeas 98 Nays 0 Absent 0

Senate Vote: Yeas 41 Nays 7 Absent 1

Chief Clerk of the House

Received by the Governor at _____ M. on _____, 2001.

Approved at _____ M. on _____, 2001.

Governor

Filed in this office this _____ day of _____, 2001,

at _____ o'clock _____ M.

Secretary of State