

**FIRST ENGROSSMENT  
with Senate Amendments****ENGROSSED HOUSE BILL NO. 1065**

Introduced by

Finance and Taxation Committee

(At the request of the Tax Commissioner)

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

8 **BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:**

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

- 11 4. Income derived from ~~carrying on a trade or~~ business activity carried on by an  
12 individual as a sole proprietorship, or through a partnership, subchapter S  
13 corporation, or other passthrough entity must be assigned to this state without  
14 regard to the residence of the individual if the ~~trade or~~ business activity is  
15 conducted wholly within this state. Income derived from gaming activity carried on  
16 in this state by an individual must be assigned to this state without regard to the  
17 residence of the individual.
- 18 5. Whenever ~~a trade or~~ business activity is carried on partly within and partly without  
19 this state by a nonresident of this state, as a sole proprietorship, or through a  
20 partnership, subchapter S corporation, or other passthrough entity, the entire  
21 income therefrom must be allocated to this state and to other states, according to  
22 the provisions of chapter 57-38.1, providing for allocation and apportionment of  
23 income of corporations doing business within and without this state.

- 1           6.   a.   Income and gains received by a resident of this state from tangible property  
2                   not employed in the business and from tangible property employed in the  
3                   business of the taxpayer, if ~~such~~ the business consists principally of the  
4                   holding of ~~such~~ the property and the collection of income and gains  
5                   therefrom, must be assigned to this state without regard to the situs of ~~such~~  
6                   the property.
- 7                   b.   Income derived from ~~carrying on a trade or~~ business activity carried on by  
8                   residents of this state, whether the business activity is conducted as a sole  
9                   proprietorship, or through a partnership, subchapter S corporation or other  
10                  passthrough entity, must be assigned to this state without regard to where  
11                  ~~such trade or~~ the business activity is conducted, and the provisions of chapter  
12                  57-38.1 do not apply. If the taxpayer believes the operation of this  
13                  subdivision with respect to the taxpayer's income is unjust, the taxpayer may  
14                  petition the tax commissioner who may allow use of another method of  
15                  reporting income, including separate accounting.
- 16                  c.   If a tax is paid to another state or territory of the United States or to the  
17                  District of Columbia on any income assigned to this state under this  
18                  subsection, a credit for any tax so paid may be deducted from the tax  
19                  assessed under this chapter if written proof of ~~such~~ the payment is furnished  
20                  to the tax commissioner; provided, that this credit for ~~such~~ the tax may not  
21                  exceed the proportion of the tax otherwise due under this chapter that the  
22                  amount of the taxpayer's adjusted gross income derived from sources in the  
23                  other taxing jurisdiction bears to the taxpayer's adjusted gross income as  
24                  computed pursuant to the Internal Revenue Code of 1954, as amended.

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

27           **57-38-08. Partnerships not subject to tax.** Partnerships are not subject to tax under  
28 this chapter. Persons carrying on a business as partners are taxable on their ~~share of the net~~  
29 ~~profits of a partnership whether the same are distributed or not and are entitled to deduct their~~  
30 ~~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. 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.
  - (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
- 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.