Following is model statutory language that can be used to implement a State tax on partnerships and S corporations. Also included in the language set forth below are provisions to be included in the relevant State personal income tax and corporate income tax statutes, with such provisions allowing for a complete offset of any unincorporated business entity tax liability against the personal income tax liability of the direct and indirect individual members of the pass-through entity by means of a credit. If the member cannot use the credit in any year, the credit will carryforward to future years, with no expiration. In addition, a credit is provided against the personal income tax liability for residents to the extent that a similar pass-through entity tax is imposed on the resident’s share of income sourced to the other state.

The language reflected below provides that pass-through entities will be able to elect to be subject to this Partnership level tax, with any such election needing to be made on an annual basis.

**Model Pass-Through Entity Tax**

1. Section 1. (NEW) (Effective from passage and applicable to taxable years commencing on or after January 1, 2018) (a) As used in this section and section 2 of this act:

2. (1) "Partnership" has the same meaning as provided in Section 7701(a)(2) of the Internal Revenue Code, and any regulations adopted thereunder. "Partnership" includes a limited liability company that is treated as a partnership for federal income tax purposes;

3. (2) "S corporation" means a corporation or limited liability company that is treated as an S corporation for federal income tax purposes;

4. (3) "Taxable year" means the taxable year of a partnership or S corporation for federal income tax purposes;

5. (4) "Affected business entity" means any partnership or S corporation that elects to be subject to tax pursuant to Section 2 of this Act;

6. (5) "Member" means (A) a shareholder of an S corporation, (B) a partner in (i) a general partnership, (ii) a limited partnership, or (iii) a limited liability partnership, and (C) a member of a limited liability company that is treated as a partnership or S corporation for federal
income tax purposes;

(6) “Direct member” means a member that holds an interest directly in an affected business entity; and

(7) "Indirect member" means a member that itself holds an interest, through a direct or indirect member that is a partnership or an S corporation, in an affected business entity.

(b) (1) Each affected business entity that is a partnership and that is [each State shall insert its doing business language] in this state shall, on or before the [each State shall insert its required filing date] following the close of each taxable year, pay a tax in an amount equal to (A) (i) the separately and nonseparately computed items, as described in Section 702(a) of the Internal Revenue Code, of the affected business entity, to the extent derived from or connected with sources within this state, as determined under the provisions of [citation to the relevant section of the State personal income tax statute], (ii) as decreased by the deduction allowed under Section 199A of the Internal Revenue Code computed as if such deduction was allowed to be taken by the affected business entity for federal tax purposes [subdivision (B) should be included in the statutory language in those States that allow individual members to take the 199A deduction in determining their State personal income tax liabilities], and (iii) as increased or decreased by any modification described in section [citation to any desired modification provisions in State statute] that relates to an item of the affected business entity's income, gain, loss or deduction, to the extent derived from or connected with sources within this state, as determined under the provisions of [citation to the State personal income tax], (B) multiplied by [relevant tax rate to be imposed on affected business entities]. If the amount calculated under subdivision (A) of this subsection results in a net loss, such net loss may be carried forward to succeeding taxable years for which the affected business entity elects to be subject to tax pursuant to section 2 of this Act until fully used. Payment shall be made with the return that is required to be filed under section [citation to any State statute requiring the filing of composite returns].

(2) Each affected business entity that is an S corporation and that is [each State shall insert its doing business language] in this State, shall, on or before the [each State shall insert its required filing date] following the close of each taxable year, pay a tax in an amount equal to (A) (i) the separately and nonseparately computed items, as described in Section 1366 of the Internal Revenue Code, of the affected business entity, to the extent derived from or connected with sources within this state, as determined under the provisions of [citation to the relevant section of the personal income tax statute],
as decreased by the deduction allowed under Section 199A of the Internal Revenue Code computed as if such deduction was allowed to be taken by the affected business entity for federal tax purposes, [subdivision (B) should be included in the statutory language in those States that allow individual members to take the 199A deduction in determining their State personal income tax liabilities] and (iii) as increased or decreased by any modification described in section [citation to any desired modification provisions in State statute], as amended by this act, that relates to an item of the affected business entity's income, gain, loss or deduction, to the extent derived from or connected with sources within this state, as determined under the provisions of [add reference to the cite for the State personal income tax], (B) multiplied by [relevant tax rate to be imposed on affected business entities]. If the amount calculated under subdivision (A) of this subsection results in a net loss, such net loss may be carried forward to succeeding taxable years for which the affected business entity elects to be subject to tax pursuant to section 2 of this Act until fully used. Payment shall be made with the return that is required to be filed under section [citation to any State statute requiring the filing of composite returns].

(c) If an affected business entity is a direct or indirect member of another affected business entity, the member affected business entity shall, when calculating its net income or loss pursuant to subdivision (b)(1)(A) or (b)(2)(A) of this section 1 of this act, subtract its distributive share of income or add its distributive share of loss from the affected business entity in which it is a direct or indirect member to the extent that the income or loss was derived from or connected with sources within this state.

(d) A nonresident individual who is a member shall not be required to file an income tax return under the provisions of [add reference to the cite for the State personal income tax] for a taxable year if, for such taxable year, the only source of income derived from or connected with sources within the state for such member, or the member and the member's spouse if a joint federal income tax return is or shall be filed, is from one or more affected business entities and such affected business entity or entities file and pay the tax due under this section.

(e) Each partnership and S corporation shall report to each of its members, for each taxable year, such member's direct pro rata share of the tax imposed under this section on such partnership or S corporation if it is an affected business entity and its indirect pro rata share of the tax imposed on any affected business entity in which such affected business entity is a direct or indirect member.
(f) (1) (A) Each person that is subject to the tax under [add cite to the State’s personal income tax] and is a member shall be entitled to a credit against the tax imposed under said [add cite to the State’s personal income tax]. Such credit shall be in an amount equal to such person's direct and indirect pro rata share of the tax paid under this section by any affected business entity of which such person is directly or indirectly a member multiplied by [insert a potential haircut percentage on the credit equal to (100-(100-the tax imposed at the entity level) to reflect that the income passed-through to the Member will reflect the reduced tax and thus less of a credit may be needed at the entity level to offset the Member’s personal income tax liability attributable to income from the affected business entity]. If the amount of the credit allowed pursuant to this subdivision exceeds such person's tax liability for the tax imposed under said chapter, such unused amount shall be carried forward to each of the succeeding taxable years by the person until such credit is fully taken against the tax under [add cite to the state’s personal income tax].

(B) Each person that is subject to the tax under [add reference to the cite for the State personal income tax] as a resident or a part-year resident of this state and is a member shall be entitled to a credit against the tax imposed under said [add cite to the State’s personal income tax] for such person's direct and indirect pro rata share of taxes paid to another state of the United States or the District of Columbia, on income of any partnership or S corporation of which such person is a member that is derived therefrom, provided the taxes paid to another state of the United States or the District of Columbia results from a tax that the [State agency or commissioner] determines is substantially similar to the tax imposed under this section. Any such credit shall be calculated in the manner prescribed by the [State agency or commissioner], which shall be consistent with the provisions of section [add cite to the State personal income tax credit provisions]. If the amount of the credit allowed pursuant to this subdivision exceeds such person's tax liability for the tax imposed under said chapter, such unused amount shall be carried forward to each of the succeeding taxable years by the person until such credit is fully taken against the tax under [add cite to the State’s personal income tax].

(2) Each company that is subject to the tax under [add cite to the State’s corporate income tax] and is a member shall be entitled to a credit against the tax imposed under said [add cite to the state’s corporate income tax]. Such credit shall be in an amount equal to such company's direct and indirect pro rata share of the tax paid under this section by any affected business entity of which such company is a member multiplied by [insert a potential haircut percentage equal to (100-(100-the tax imposed at the entity level) to reflect that the income passed-through to the Member will reflect the reduced tax and thus less of a credit may be needed at the entity level to offset the Member’s corporate income tax liability attributable to income from the affected business entity]. Such credit shall be applied after all
other credits. Any credit that is not used in the taxable year during which the company reports the net income from such affected business entities shall be carried forward to each of the succeeding taxable years by the company until such credit is fully taken against the tax under [add cite to the State’s corporate income tax].

The provisions of sections [citation to any desired administrative procedure provisions in State statute, including any estimated payment provisions] shall apply to the provisions of this section in the same manner and with the same force and effect as if the language of said sections had been incorporated in full into this section and had expressly referred to the tax under this section, except to the extent that any such provision is inconsistent with a provision of this section.

Sec. 2. (NEW) (Effective from passage and applicable to taxable years commencing on or after January 1, 2018) (a) A partnership or an S corporation may elect in the manner set forth in subsection (b) of this section to become an affected business entity that is required to pay the tax under section 1 of this act in any taxable year. A separate election shall be made for each taxable year.

(b) (1) An election under subsection (a) of this section shall be made on such form and in such manner as the [insert state agency or commissioner] may prescribe by regulation or instruction.

(2) An election under subsection (a) of this section may be made for any taxable year at any time on or before the [each state shall insert its required election date] of such taxable year.

(3) An election made under paragraph (b)(1) of this Section 2 of the act must be signed by:

(A) Each member of the electing entity who is a Member at the time the election is filed; or

(B) Any officer, manager, or Member of the electing entity who is authorized (under local law or the entity’s organizational documents) to make the election and who represents to having such authorization under penalties of perjury.