Business Tax Administrative Rule 601.23-2

601.23-2 – Partnerships – Partner Level Deduction Election (LIC-6.27)
In determining net income for a partnership, deductible expenses attributable to the business of the partnership which are paid or incurred by any partner may be deducted by the partnership provided an election is made. The initial election requires all partners in the partnership to sign the election statement to indicate their agreement to the election. Each year following, the Tax Matters Partner (TMP) or a general partner when no TMP is designated, must attach an election affirmation statement that reaffirms the election. If new partners have been admitted to the partnership during the year, the TMP or general partner must identify those new partners, the date of their entry into the partnership, and assure that each new partner has signed the election affirmation statement to indicate their agreement to the election. The election affirmation statement must be attached to the return each year. If an election under this Rule is made, the partnership shall provide a schedule attached to the return showing such deductions taken to determine the net income of the partnership.

Example 1: DCH partnership has three partners (each a professional corporation with two shareholder/employees). Each of the partners derives 100% of their income from the partnership. The partnership has $465,000 of sales and incurs $20,000 of deductible expenses. Each partner also pays $60,000 of expenses, which includes $5,000 for a qualified pension plan for the shareholder/employees, $50,000 for compensation to owner/ employees and $5,000 for other expenses. DCH partnership has filed an election under this Rule. The net income of DCH partnership is determined as follows:

1. Ordinary Income of Partnership (Sales of $465,000 less $20,000):	$445,000
2. Less Partner-Level Deductions (compensation to owner is not deductible):	($30,000)
3. Adjusted Net Income	$415,000

4. Owners Compensation Deduction: See Administrative Rule 601.23-3 (LIC 1.07) (6 general partner owners)

The corporate partners are not required to file separately because they have no other income other than from the partnership.

Example 2: PRO Partnership has three partners (two individuals and one corporation). The corporate partner also has $100,000 of business income from other business activity unrelated to the partnership business. The partnership has $500,000 of sales and incurs $50,000 of deductible expenses. The two non-corporate partners each pay $10,000 of deductible partnership expenses on their personal returns. No partnership expenses are incurred or paid directly by the corporate partner. PRO Partnership has filed an election under this Rule. The net income of PRO Partnership is determined as follows:

1. Ordinary Income of Partnership

(Sales of $500,000 less $50,000): $450,000

2. Less Partner-Level Deductions: ($20,000)

3. Adjusted Income: $430,000

4. Owners Compensation Deduction: 3 General Partner owners allowed

The corporate partner is required to file separately for the $100,000 unrelated income. K-1 income flowing from the partnership shall be adjusted (K-1 gains shall be deducted, K-1 losses shall be added) before determination of net income for the separate filing of the corporate partner.

Note: Applicable for tax years beginning on or after 1/1/2023.

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Date	Director, Revenue Division

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