



# This Week in State Tax (TWIST)

August 5, 2024



## Illinois: Investment Partnership Regulation Issued

Effective July 11, 2024, the Illinois Department of Revenue adopted changes to its Investment Partnership classification regulation in Ill. Admin. Code tit. 86, § 100.9730 and has adopted a new regulation with guidance on Investment Partnership nonresident withholding in Ill. Admin. Code tit. 86, § 100.7034. These regulations relate to statutory changes enacted in June 2023 in Senate Bill 1963; the law changes are effective for tax years ending on or after December 31, 2023. Please see KPMG's TWIST from [June 12, 2023](#) for a detailed description of the statutory changes. The text of the adopted regulation is available in the July 26, 2024, [Illinois Register](#) (pp. 10846- 10876).

The changes regarding Investment Partnership classification are consistent with the statutory changes. For tax years ending on or after December 31, 2023, prior guidance on applying the "asset test" and "income test" computations has been retained. For the "income test," the rule considering lower-tier partnership income in the test is limited only to tax years ending before December 31, 2023, to reflect that the income test now includes the distributive share of partnership income from lower-tier partnerships classified as a security under subsection (a)(1) of Subchapter 77b of Chapter 2A of Title 15 of the United States Code.

The regulation provides several clarifications to the new nonresident withholding requirement. The base for the withholding is the sum of two elements. The first element is the Investment Partnership's distributable share of business income from other partnerships that would be apportioned to Illinois. The second element is Investment Partnership's distributable share, considering IRC sections 702 and 704, of nonbusiness income from other partnerships that would be allocated to Illinois excluding the types of nonbusiness income that are allocated based on commercial domicile (e.g., interest, dividends, capital gains, and losses from sales or exchanges of intangible personal property). When the Investment Partnership holds interests in multiple partnerships, the income and losses from those partnerships may be netted in determining the nonresident withholding base, but losses from other types of investments held by the Investment Partnership may not be netted against income in computing the nonresident withholding base.

In general, a nonresident partner is not permitted to claim the amount withheld by an Illinois Investment Partnership as a reduction to the nonresident partner's taxes due. However, the regulation indicates specific instances when a nonresident partner will be permitted to claim the withheld amount. While a nonresident partner would generally treat distributive share income from the Illinois Investment Partnership as nonbusiness income, if the nonresident partner elects or is required to treat its share as business income, then such partner is permitted to claim the Investment Partnership withholding. An upper-tier Illinois Investment Partnership is permitted to claim the withholding from a lower-tier Illinois Investment Partnership to reduce the upper-tier Illinois Investment Partnership's amount of nonresident withholding on its partners. If Illinois residents are partners in an upper-tier partnership which is reported Illinois Investment Partnership withholding by a lower-tier partnership, the distributive share of any withholding remaining after satisfying any amounts owed to Illinois by the upper-tier partnership, can be claimed by the Illinois resident partners. A nonresident partner, other than an individual, that is commercially domiciled in Illinois is allowed to claim the Investment Partnership withholding related to its income from the Investment Partnership. An Illinois Investment Partnership that overpays its withholding for the



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tax year is generally entitled to a refund of that overpayment. However, if the withholding relates to a partner that will be able to claim that withholding under the preceding rules, the Investment Partnership is not permitted to claim a refund for the withholding overpaid. In that situation, the prescribed remedy is for the partner to report the withholding and claim a refund for any amount that exceeds the partner's tax due.

The regulation also provides guidance on the interaction of the Illinois Investment Partnership nonresident withholding requirement and the elective Illinois Pass-through Entity Tax (IL PTET). The regulation indicates that an Investment Partnership that elects IL PTET remains subject to the Illinois Investment Partnership withholding requirement. If the Investment Partnership is invested in another partnership that elects IL PTET, the Investment Partnership may use its share of IL PTET Credit that relates to its nonresident partners to reduce the amount of withholding tax it would otherwise owe. If the Investment Partnership itself elects IL PTET, it may elect to reduce its IL PTET base by the amount of income that will be included in its base for Illinois Investment Partnerships nonresident withholding.

The new regulation includes numerous examples that apply the withholding requirement to various structures under different facts. Please contact [Brad Wilhelmson](#) with questions.

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