



TaxNewsFlash

United States

No. 2026-248
October 6, 2026

California: IRC section 751(a) gain sourced to taxpayers' states of residence (Office of Tax Appeals decision)

The California Office of Tax Appeals (OTA) on October 5, 2026, published a decision holding that gain under IRC section 751(a) from the sale of a non-unitary partnership interest was sourced to the taxpayers' states of residence.

The taxpayers in the case owned interests in an upper-tier investment company treated as a partnership for tax purposes, which owned a minority interest in a lower-tier partnership that engaged in business in California and other states. The upper-tier partnership sold portions of its ownership interest in the lower-tier partnership, and under guidance from the California Franchise Tax Board (FTB), gain from the sale was to be sourced using the lower-tier partnership's apportionment factors. However, the OTA disregarded this guidance and agreed with the taxpayers that the gain from the sale of partnership interests was entirely sourced to the taxpayers' states of residence.

IRC section 751(a) provides that the portion of gain from the sale of a partnership interest attributable to certain partnership assets (unrealized receivables and inventory) is treated as "an amount realized from the sale or exchange of property other than a capital asset." In Legal Ruling 2022-02, the FTB interpreted this provision to treat the gain as arising from the sale by the partnership of the underlying property. Under that view, the gain constitutes income that must be sourced using the partnership's apportionment factors. The OTA rejected the FTB's interpretation of the IRC, relying in part on the U.S. Court of Appeals for the D.C. Circuit's decision in *Rawat v. Commissioner* (2024) that rejected a similar position advanced by the IRS.

Both the D.C. Circuit and the OTA concluded that IRC section 751(a) changes only the character of the gain—treating it as ordinary income rather than capital gain—without treating the transaction as a sale of the partnership's underlying assets. The OTA also distinguished this case, in which the partnership interest sold was not unitary with its owner, from a case involving a holding partnership's sale of a unitary operating partnership; in the latter situation, the gain is apportioned as income from a unitary business. Here, the gain was properly treated as ordinary income from the sale of a non-unitary intangible asset—the partnership interest. California's division-of-income rules therefore required the gain to be sourced to the indirect owners' states of residence.

This OTA decision is "Pending Precedential." A taxpayer that previously treated IRC section 751(a) gain as the sale of other than a partnership interest (e.g., inventory or unrealized receivables) may have refund opportunities.

Contact us

For more information, contact a KPMG state and local tax professional:

Oksana Jaffe | ojaffe@kpmg.com

Geoff Way | geoffreyway@kpmg.com

Datus Tomasovich | dtomasovich@kpmg.com

kpmg.com/socialmedia



The information contained in TaxNewsFlash is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230, as the content of this document is issued for general informational purposes only, is intended to enhance the reader's knowledge on the matters addressed therein, and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

Direct comments, including requests for subscriptions, to [Washington National Tax](#). For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at +1 202.533.3712, 1801 K Street NW, Washington, DC 20006-1301.

To unsubscribe from TaxNewsFlash, reply to [Washington National Tax](#).

[Privacy](#) | [Legal](#)