**Section 100.7034 Investment Partnership Withholding (IITA Section 709.5)**

a) In General. *For taxable years ending on and after December 31, 2023*, a taxpayer that is an *investment partnership, as defined in* IITA *Section 1501* and Section 100.9730, and is a member of one or more other partnerships (as defined in Section 100.9750(d)) with income allocable or apportionable to Illinois *shall withhold from each nonresident partner an amount as calculated* in subsection (c).

b) Exemption from Withholding.

1) An investment partnership is not required to withhold an amount from a nonresident partner:

A) Who is *exempt from tax under IRC Section 501(a) or* IITA *Section 205*. Under the provisions of IITA Section 709.5(d), an investment partnership is required to withhold an amount with respect to a partner that is itself a partnership or S corporation.

B) Who *is a retired partner, to the extent that partner's distributions are exempt from tax under* IITA *Section 203(a)(2)(F)*.

2) *The provisions of* IITA Section 709.5(c), *allowing for exemption from withholding, shall not apply for purposes of this* Section. (IITA Section 709.5(d))

3) No nonresident partner has any right of action against an investment partnership for withholding tax from that partner despite exemption under this subsection. (See IITA Section 712.) Instead, the investment partnership may file a claim for credit or refund as provided in subsection (h).

c) Withholding Tax Computation.

1) The amount of withholding tax due from the investment partnership is equal to:

A) *The sum of*:

i) *the* investment partnership's distributable *share of income* from other partnerships *that*, but for the provisions of IITA Sections 205(b) and 305(c-5), *would be apportioned to Illinois by the investment partnership under* IITA *Section 305(a); and*

ii) *the* investment partnership's distributable share of income from other partnerships *that, but for the provisions of* IITA Sections 205(b) and *305(c-5), would be allocated to Illinois by the investment partnership under* IITA *Sections 305(b) and 303 (other than* nonbusiness income that is *allocated* based on *commercial domicile) that is distributable to* each nonresident *partner* of the investment partnership *under IRC Sections 702 and 704 (whether or not distributed)*;

B) *Multiplied by the applicable rates of tax for that partner under* IITA *Section 201(a) through (d), net of the investment partnership's distributive share of any* IITA *Article 2 credit* passed through from other partnerships *and first allowable against the tax liability of that partner for a taxable year ending on or after December 31, 2023*. (IITA Section 709.5(d)(1) through (3))

2) In computing the required amount of withholding tax, an investment partnership's distributive share of Illinois source losses from other partnerships, to the extent distributable to its nonresident partners, may be netted against its distributive share of Illinois source income distributable to nonresident partners.

3) Losses and deductions from other investments of the investment partnership may not be netted against income subject to withholding for purposes of computing the amount of withholding tax owed.

4) Only credits and losses passed through in the current year of the investment partnership may reduce the required withholding amount. Any excess credits and losses from other years may not be carried over in determining the amount of withholding tax owed.

5) If an investment partnership invests in a partnership that makes the Pass-through Entity tax election, the investment partnership may use the credit allowed under IITA Section 201(p) to reduce its amount of withholding tax owed, to the extent that such credit would otherwise be distributable to its nonresident partners.

d) Withholding Tax Rate.  *If the* nonresident *partner is a partnership or subchapter S corporation, the* applicable withholding tax *rate* in subsection (c)(1)(B) is *equal to the individual* tax *rate under* IITA *Section 201(b)*. (IITA Section 709.5(d)(2))

e) Time for Filing Return and Paying Tax Withheld. An investment partnership *required to withhold tax under* IITA *Section 709.5(d) shall report the amounts withheld and the owners from whom the amounts were withheld, and pay over the amounts withheld, no later than the due date (without regard to extensions) of the tax return for the taxable year* of a partnership. (IITA Section 711(a-5)) For purposes of abatement of penalties under Section 3-8 of the Uniform Penalty and Interest Act, an investment partnership shall be deemed to have reasonable cause for not filing the report by the due date required under this subsection if the report is filed no later than the due date under IITA Section 505 (including extensions) of the return for the taxable year.

f) Credit for Taxes Withheld.

1) Except as provided in this Section, *no credit for taxes withheld shall be allowed* to the nonresident partners of an investment partnership *under* IITA *Section 709.5(b) for amounts withheld under this* Section by the investment partnership. (IITA Section 709.5(d))

2) A nonresident partner is entitled to a credit as provided in IITA Section 709.5(b) and Section 100.7035(d) if the nonresident partner's share of the income of an investment partnership is business income under IITA Section 305(c-5).

3) If an investment partnership is itself a member of a second investment partnership and the second investment partnership is subject to nonresident partner withholding, as required in this Section, the first investment partnership is allowed a credit against its withholding requirement under this Section for the withholding amount paid by the second investment partnership on income distributable to the nonresident partners of the first investment partnership.

4) If one of the partners of an investment partnership is itself a partnership, subchapter S corporation, or trust, with Illinois resident partners, shareholders, or beneficiaries, the Illinois resident partners, shareholders, or beneficiaries may claim a credit for their shares of withholding tax paid by the investment partnership, less their shares of any amount applied by the partnership against its own liability for tax, against their liability under IITA Section 201 for the taxable year in which that income is included in base income.

5) Nonresident taxpayers (other than individuals) that are commercially domiciled in Illinois and have income from an investment partnership are allowed a credit for their shares of withholding tax paid by the investment partnership.

6) The total amount of credit claimed under this subsection (f) may not exceed the amount of tax withheld by the investment partnership with respect to the partner.

g) Pass-through Entity Tax Election. An investment partnership may elect to be subject to Pass-through Entity tax under IITA Section 201(p) (PTE tax). Any investment partnership that elects to pay PTE tax is not exempt from the withholding requirement under this Section. However, an investment partnership may elect to subtract its income subject to the withholding requirement when computing its PTE tax under IITA Section 201(p).

h) Overpayments. An investment partnership may claim a refund or credit for any overpayment of withholding due under this Section, except to the extent the overpayment is attributable to tax withheld on the distributive share of a partner who is allowed a credit for such withholding under subsection (f). In addition, no partner has any right of action against an investment partnership for overpayment of withholding. (See IITA Section 712.) With respect to an overpayment of withholding that is attributable to tax withheld on the distributive share of a partner who is allowed a credit for such withholding under subsection (f), the remedy is for the partner to file a timely claim for credit or refund for any amount withheld under this Section.

i) Underpayments. If an investment partnership fails to timely pay the full amount of withholding due under this Section, the investment partnership is not relieved of its obligation to pay any amount due with respect to a partner, except to the extent such underpayment is attributable to withholding required on a partner's distributive share of income which, under the provisions of IITA Section 305(c-5), is business income or is allocable to Illinois and if the partner has paid its liability under the IITA on the income from which withholding was required without claiming the credit otherwise allowed under subsection (f). In addition, the investment partnership is not relieved of any penalty or interest otherwise applicable with respect to its failure to timely pay the withholding. (See IITA Section 713.)

j) Examples. The following examples may be used to illustrate the provisions of this Section.

EXAMPLE 1. Assume Partnership A, an investment partnership, consists of equal partners B and C. Partner B is a partnership and Partner C is a nonresident individual. In addition, assume that both Partnership A and Partner B are commercially domiciled in Illinois and that neither Partnership A nor Partner B has made the election under IITA Section 201(p) to be subject to PTE tax. For its taxable year ending December 31, 2023, Partnership A's income consists of the following:

|  |  |
| --- | --- |
| Dividends | $200 |
| Capital gains | $1,200 |
| Distributive share income:  Business income apportioned to Illinois (305(a)) | $600 |
| Nonbusiness rent income from IL real estate (303) | $400 |
|  | $1,000 |
| Total | $2,400 |

Partnership A computes withholding tax of $49.50. Tax is computed on the sum of $600 apportioned to Illinois under IITA Section 305(a) and the $400 allocated to Illinois under IITA Section 305(b), multiplied by the 4.95% individual rate of its partners (including Partner B). Partner C may not claim credit under IITA Section 709.5(b) for its respective share of withholding tax.

Because Partner B is not an investment partnership, it is not subject to withholding tax under IITA Section 709.5(d). However, as Partner B is commercially domiciled in Illinois, it is subject to replacement tax on its $500 distributive share (along with any other sources of Illinois net income) and may be subject to withholding under IITA Section 709.5(a) with respect to other sources of income. Under the provisions of IITA Section 305(c-5), Partner B's distributive share is deemed nonbusiness income and allocable to the taxpayer's commercial domicile. Therefore, all of Partner B's distributive share is subject to replacement tax and not just its share of $500 on which Partnership A paid withholding tax. Under subsection (f)(5), Partner B may claim a credit for the tax withheld on its distributive share. IITA Section 709.5(b) and Section 100.7035(d)(1) allow Partner B to claim a credit against its withholding obligation under IITA Section 709.5(a) in lieu of claiming the credit against its liability under IITA Section 201. If Partner B has Illinois resident partners, those partners may not claim credit under subsection (f)(4) for any amount claimed as a credit by Partner B against its liability as provided in Section 100.7035(d)(1).

EXAMPLE 2. Assume the same facts as in Example 1, except that Partnership A also has distributive share of nonbusiness rental losses of $200 from Illinois real estate under IITA Sections 305(b) and 303. In computing the required amount of withholding, Partnership A's distributive share of Illinois source losses distributable to its nonresident partners may be netted against its distributive share of Illinois source income distributable to its nonresident partners. Therefore, Partnership A computes withholding tax of $39.60. Tax is computed on the sum of $600 apportioned to Illinois under IITA Section 305(a) and the $400 allocated to Illinois under IITA Section 305(b), less the $200 allocated to Illinois under IITA Section 305(b), multiplied by the 4.95% individual rate of its partners (including Partner B). Partner C may not claim credit under IITA Section 709.5(b) for its respective share of withholding tax.

EXAMPLE 3. Assume the same facts as in Example 1, except that Partnership A has $5 of an IITA Article 2 credit passed through from Partnership Z, which is first allowable against the tax liability of Partnership A for its tax year ending on December 31, 2023, and $200 of an Article 2 credit passed through from Partnership Z carried over from its tax year ending on December 31, 2022. Partnership A computes withholding tax of $44.50, the $49.50 determined as provided in Example 1 less the $5 Article 2 credit passed through from Partnership Z.

EXAMPLE 4. Assume the same facts as in Example 1, except that Partnership A has $3,000 of an Article 2 credit passed through from Partnership Z which is first allowable against the tax liability of Partnership A for its tax year ending on December 31, 2023. Partnership A would compute no withholding tax. Partnership A may not use the excess credit amount against any future withholding tax obligation.

EXAMPLE 5. Assume Partnership A, an investment partnership, consists of equal partners B, C, and D. Partner B is itself an investment partnership, whose partners include resident individuals E and F, and nonresident individual G. Partners C and D are nonresident individuals. In addition, assume that both Partnership A and Partner B are commercially domiciled in Illinois and that neither Partnership A nor Partner B has made the election under IITA Section 201(p) to be subject to PTE tax. For its taxable year ending December 31, 2023, Partnership A's income consists of the following:

|  |  |
| --- | --- |
| Dividends | $500 |
| Capital gains | $1,000 |
| Distributive share income:  Business income apportioned to Illinois (305(a)) | $800 |
| Nonbusiness dividend income (305(b), 301(c)(2)) | $100 |
| Nonbusiness rent income from IL real estate (303) | $400 |
|  | $1,300 |
| Total | $2,800 |

Partnership A computes withholding tax of $59.40. Tax is computed on the sum of $800 apportioned to Illinois under IITA Section 305(a) and the $400 allocated to Illinois under IITA Section 305(b), multiplied by the 4.95% individual rate of its partners (including Partner B). Partners C and D may not claim credit under IITA Section 709.5(b) for their respective shares of withholding tax.

Partner B, an investment partnership, owes no withholding tax. Although Partner B, but for the provisions of IITA Section 305(c-5), has total income apportioned to Illinois under IITA Section 305(a) and (b) of $400, $133.33 of which is distributable to nonresident individual G, resulting in a withholding tax of $6.60, Partner B is allowed a credit under subsection (f)(3) against its withholding obligation under this Section of $6.60. In addition, resident individuals E and F may each claim a credit under subsection (f)(4) of $6.60 against their liability under IITA Section 201 for their taxable year in which their distributive shares of Partner B's income is included in base income. The credit shall be applied as provided in IITA Section 709.5(b).

EXAMPLE 6. Assume the same facts as in Example 5, except that Partnership A makes the election under IITA Section 201(p) to be subject to PTE tax for its tax year ending December 31, 2023. Making the election does not exempt Partnership A from the requirement to withhold under IITA Section 709.5(d). However, Partnership A may elect to subtract its income subject to withholding in computing its base income under IITA Section 201(p)(3). Therefore, Partnership A's base income for purposes of computing PTE tax is $1,600 ($2,800 - $1,200). If Partner B also makes the election under IITA Section 201(p), it subtracts its distributive share of Partnership A's income in computing its base income under IITA Section 201(p)(3).

EXAMPLE 7. Assume the same facts as in Example 5, except that Partner B is a corporation that is commercially domiciled outside of Illinois. In addition, assume that Partner B makes the election under IITA Section 1501(a)(1) to treat all of its income as business income. Partnership A computes withholding tax of $77.60. Tax is computed on the sum of $800 apportioned to Illinois under IITA Section 305(a) and the $400 allocated to Illinois under IITA Section 305(b), multiplied by the 9.5% rate applicable to Partner B's distributive share and the 4.95% rate applicable to Partners C and D's distributive shares. Partners C and D are not allowed a credit under IITA Section 709.5(b) for their respective shares of withholding tax. Under IITA Section 305(c-5), Partner B's distributive share is treated as business income and apportioned as if Partner B received the income directly (rather than as a distributive share of Partnership A's income). Therefore, Partner B's Illinois net income includes its $267 distributive share of Partnership A's distributive share of business income (one-third of $800). Partner B may treat its $38 share of tax withheld by Partnership A as a credit as provided in IITA Section 709.5(b) and Section 100.7035(d). Partner B's distributive share of Partnership A's other items of income is deemed business income and apportioned using Partner's apportionment factor.

EXAMPLE 8. Assume Partnership A is an investment partnership and has income subject to withholding of $1,000. Investment Partnership A consists of Partner B, who is itself an investment partnership and whose partners include Partner C, a corporation. Investment Partnership A is not required to withhold with respect to Investment Partnership B's share, but if it does withhold at the 4.95% rate, then Investment Partnership B may use that amount as a credit against its own withholding tax liability. In this scenario, Investment Partnership B has income subject to withholding with respect to its distributive share of Investment Partnership A's income subject to withholding. Under IITA Section 709.5(d)(1) and Section 100.3500(b)(3) of this Part, Investment Partnership B has income that would, but for the provisions of IITA Section 305(c-5), be apportioned or allocated under IITA Section 305(a) or (b). Therefore, Investment Partnership B owes withholding tax of 9.5% on Corporate Partner C's distributive share less any credit for the share of withholding tax paid by Investment Partnership A.

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