



This Week in State Tax (TWIST)

June 12, 2023



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Illinois: Investment Partnership Status Changes Enacted

On Wednesday, June 7, 2023, Governor Pritzker signed an income tax omnibus bill, Senate Bill 1963, which includes changes to the Illinois Investment Partnership test and new requirements for certain Illinois Investment Partnerships. These changes are effective for tax years ending on or after December 31, 2023, which means payments that will become due on April 15, 2024 may be impacted.

For tax years ending before December 31, 2023, the test for Illinois Investment Partnership status has had three elements that all needed to be met to qualify. These elements are:

1. no less than 90 percent of the partnership's cost of its total assets consists of qualifying investment securities, deposits at banks or other financial institutions, and office space and equipment reasonably necessary to carry on its activities as an investment partnership,
2. no less than 90 percent of the partnership's gross income consists of interest, dividends, and gains from the sale or exchange of qualifying investment securities, and
3. the partnership is not a dealer in qualifying investment securities.

As defined in Illinois authority, the term "qualifying investment securities" has only included the holding of another partnership if that partnership itself was an Illinois Investment Partnership. In addition, partnerships that qualified as Illinois Investment Partnerships were excluded from the general requirement for partnerships to withhold on the Illinois sourced portion of the distributive shares of nonresident partners.

Effective for tax years ending on or after December 31, 2023, Article 50 of this legislation has three primary components that change the Illinois Investment Partnership rules. These components impact the third element of the test, permit additional partnership interests held to qualify as "qualifying investment securities," and create a new withholding requirement for certain income of Illinois Investment Partnerships.

Specifically, the third prong of the test, which prohibited the partnership from being a dealer in qualifying investment securities, will be removed. However, after the changes, "qualifying investment securities" will not be permitted to include securities with respect to which the taxpayer is required to apply the rules of Internal Revenue Code section 475(a). As such, the focus has changed from the dealer status of the partnership entity to a focus on the assets it holds. This distinction will need to be considered when performing the 90 percent asset and gross income tests.

Another change is that the definition of "qualifying investment securities" was expanded to also include a partnership interest that, in the hands of the partnership that is determining its status as an Illinois Investment Partnership, qualifies as a

security within the meaning of subsection (a)(1) of Subchapter 77b of Chapter 2A of Title 15 of the United States Code. The 90 percent gross income tax was adjusted to provide that no less than 90 percent of the partnership's gross income consists of interest, dividends, gains from the sale or exchange of qualifying investment securities, and the distributive share of partnership income from lower-tier partnership interests (not including lower-tier partnerships that are operating at a federal taxable loss) meeting the definition of qualifying investment security because of classification as a security under subsection (a)(1) of Subchapter 77b of Chapter 2A of Title 15 of the United States Code. Along with continued testing to determine if the 90 percent asset and gross income tests are met, a partnership considering its Illinois Investment Partnership status may need to perform additional analysis to determine if its holdings of other partnerships would meet the specified standard.

Finally, partnerships that qualify as Illinois Investment Partnerships remain excluded from the general nonresident withholding rules on nonresident partners but will be subject to a new set of withholding rules specific to Illinois Investment Partnerships. For nonresident partners, other than exempt organization and retired partners, an Illinois Investment Partnership will be required to withhold on a base including the income apportioned to Illinois under rules for non-qualifying partnerships. This withholding base also includes nonbusiness income 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). The tax rates used for withholding are the Income and Replacement Tax rates relevant to the nonresident partner, except when the partner is an S corporation or another partnership then the individual rate (currently 4.95 percent) would be used. The amount withheld on a nonresident partner can be reduced by the partner's distributive share of Illinois tax credits. Under the standard withholding rules, Illinois permits certain partners to provide waivers that remove the partnership's withholding requirement, but the withholding rules for Illinois Investment Partnerships do not permit these waivers. In general, a nonresident partner is not permitted to claim the amount withheld by an Illinois Investment Partnership if it files an Illinois tax return, though these owners might not be required to file in Illinois based on other rules. The specific withholding rules for Illinois Investment Partnerships will require a qualifying entity to prepare additional computations of the withholding amount due and make related payments of this withholding. Please contact [Brad Wilhelmson](#) with questions.



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