

DEPARTMENT OF STATE REVENUE

Information Bulletin #72
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SUBJECT: S Corporation, Trust, and Partnership Mandate to File a Composite Return on Behalf of Nonresident Shareholders and Partners

REFERENCES: [IC 6-3-3-5](#); [IC 6-3-4-12](#); [IC 6-3-4-13](#); [IC 6-3-4-15](#)

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SUMMARY OF CHANGES

Apart from nonsubstantive, technical changes, this version of the bulletin has been changed to clarify that the college credit for contributions is not allowed to offset tax liabilities of shareholders and partners, to specify treatment for interest under IRC Section 163, and to clarify disallowance for credit carryforwards. In addition, the bulletin has also been updated to reflect the creation of Schedule Composite COR for withholding on nonresident C corporations and to reflect procedures applicable to changes enacted by HEA 1316-2018(ss). Further, the bulletin has been updated to clarify rules on composite withholding for local income taxes and the interplay between composite returns and return filings by a shareholder or partner. Finally, the bulletin has been revised to provide rules for treatment of corporate partners.

OVERVIEW

NOTE: Due to the similar treatment of composite returns for S corporations, trusts, estates, and partnerships, whenever this bulletin mentions "pass through entity" or "owner," it refers to S corporations, trusts and estates, or partnerships and their shareholders, beneficiaries, or partners, respectively.

Pass through entities are required to file composite adjusted gross income tax returns on behalf of all nonresident owners. Unless they have income from other Indiana sources, nonresident owners are then relieved of the obligation to file an individual adjusted gross income tax return. Corporate owners and other non-individual owners of a partnership or trust are still required to file returns.

However, if the nonresident owner files an Indiana return, all Indiana income, losses, and other tax attributes must be reported on that return even if a pass through entity files a composite return. For example, if an owner has \$20,000 of income from a pass through entity and \$40,000 from an unrelated sole proprietorship, the owner must report all \$60,000 of income. Any composite tax remitted by the pass through entity is then treated as tax withheld on behalf of that owner.

Further, in the event of loss or credit carryovers, the owner must file a return in order to claim the loss or credit and to properly use the credit.

COMPOSITE RETURN LIMITATIONS

The following limitations and conditions apply to those owners included in a composite return.

- Any short-term capital gain (loss) plus any long-term capital gain (loss) specifically allocated to shareholders shall be allowed subject to any "passive activity" loss limitations pursuant to IRC Section 469 and capital loss limitations imposed on taxpayers by IRC Section 1211. Such limitation shall be determined as if the pass through entity was the sole source of the owner's Indiana income.
- Any deduction required for interest disallowed under IRC Section 163(j) shall be permitted. Any addback for the owner shall be determined as if the pass through entity was the sole source of the owner's Indiana income.
- No credit carryforwards shall be permitted except to the extent specifically permitted in the instructions for the relevant entity form (i.e., IT-20S, IT-41, or IT-65). For 2019, these credits are the credits reported on Schedule IN-OCC.

- No deduction shall be permitted for interest paid on investment indebtedness under Section 163(d) of the IRC (limitation on investment interest indebtedness).
- No deduction shall be permitted for net operating losses.
- No personal exemptions shall be permitted.
- No deduction shall be allowed for charitable contributions allowed or allowable pursuant to Section 170 of the IRC.
- Any college credit for contributions is **NOT** permitted pursuant to [IC 6-3-3-5](#).
- No credit shall be permitted unless the provisions of the credit specifically allow flow-through of the credit to owners.
- No credit is permitted for taxes paid to other states.
- Any refund of state or county taxes will be remitted directly to the pass through entity.

SPECIAL NOTE FOR LOCAL INCOME TAXES

As a general rule, withholding and remittance of local income tax for non-resident owners is not required. However, in the case in which the non-resident owner has a principal place of employment or self-employment in an Indiana county on January 1, withholding of local income tax is required for the county of principal employment or business.

Thus, for instance, if an individual has their principal place of employment in St. Joseph County on January 1, does not change their principal place of business or employment, and owns an interest in an S corporation doing business in both St. Joseph County and Elkhart County, the portion of the S corporation's income from St. Joseph County is subject to local income tax, while the portion from Elkhart County is not subject to local income tax.

The requirement for reporting county tax for composite tax purposes shall begin for taxable years beginning after December 31, 2019. However, this does not relieve the owner of the requirement to report county income tax on the owner's return if the tax is otherwise required.

If the individual has provided a Form WH-4 to the pass through entity for employee withholding tax, the pass through entity shall also use that information to determine the county for nonresident withholding. Also, the owner may provide a Form WH-4 to corporation pass through entity if the pass through entity does not have a form on file.

If an individual owner is subject to Indiana local income tax, the individual **MUST** file Form IT-40PNR.

COMPOSITE FILING PROCEDURES

The following procedures must be followed by S corporations, partnerships, trusts, and estates filing composite returns:

- (1) For withholding on non-corporate entities (individuals, trusts, and other pass-through entities, including S corporations), complete the Schedule Composite and set out the calculation of tax attributable to each nonresident shareholder. Indicate the names of all nonresident shareholders required to be included in the composite return. For nonresident C corporations, use the Schedule Composite COR and include similar information.

For a corporate entity, the entity should be treated (1) as a C corporation unless the entity responsible for withholding knows that the corporation is an S corporation and (2) for purposes of any foreign source dividend deduction, be treated as an S corporation unless the entity responsible for withholding knows that the corporation is a C corporation. Withholding for C corporations is required at the C corporation tax rate (or financial institutions tax if the corporation is subject to that tax) unless the C corporation is not subject to tax (e.g., a charitable organization) AND the income is known to not be unrelated business income for the C corporation.

A partnership may rely on the good-faith representation of a corporate entity with regard to whether the corporation is a C corporation or an S corporation, and as to whether a non-profit can treat income as unrelated business income.

Subject to the limitations above, separately compute the Indiana tax liability of each nonresident owner. Enclose these composite schedules with the S Corporation Income Tax Return (Form IT-20S), the Partnership Return (Form IT-65), or the Fiduciary Income Tax Return (Form IT-41).

NOTE: For a partnership or S corporation, composite income means each nonresident owner's distributive share of income, including modifications and deductions, from the partnership or S corporation that is derived from sources within Indiana as determined by the use of the apportionment formula described in [IC 6-3-2-2\(b\)](#) on the partnership's or S corporation's income. Any limitations imposed on the respective owners by Section 469 of the Internal Revenue Code (passive activity loss rules) will apply to the composite return.

A pass through entity is not required to include a publicly traded partnership in the composite return if the publicly traded partnership is qualified under Section 7704(c) of the Internal Revenue Code and has agreed to file an information return listing the name, address, and taxpayer identification number for each unit.

Publicly traded partnerships are not required to withhold or file composite returns for their partners.

(2) Enter the total tax liability on Form IT-20S, IT-41, or IT-65 of those nonresident owners included in the composite return. Enter this amount on the line for total composite tax. Any nonrefundable credits permitted to be used on the composite return and allowed to be passed through may be used to reduce the reported tax due amount.

(3) Insert the total amount paid with Form IT-6-WTH on behalf of the nonresident owners included in the composite return, on the line for total composite withholding IT-6-WTH payments. Do not include amounts to be paid with the filing of the IT-20S, IT-65, or IT-41 as payment of composite tax due.

(4) Any balance due or overpayment reported as a result is to be remitted by or refunded to the pass through entity.

COMPOSITE WITHHOLDING PAYMENTS (FORM IT-6WTH)

Amounts withheld from nonresident owners included in the composite return should be remitted with Form IT-6WTH. Payment is due the 15th day of the 4th month following the close of the pass through entity's tax period. Multiple payments and IT-6-WTH vouchers may be filed throughout the tax year or during the extension period. If additional payments are necessary, please remit such taxes through the department's e-services portal, INTIME, available at https://intime.dor.in.gov/eServices/_/.

The pass through entity filing a composite return for the nonresident owners is liable for the tax shown on the return and for any additional tax, interest, and penalty as a result of a subsequent audit and examination. However, if an owner has a zero or negative income after modifications, do NOT include the owner on a composite schedule. A penalty of \$500 is imposed on a partnership or S corporation that fails to file a composite return for all nonresident shareholders. However, if the composite return otherwise includes an owner with zero or negative income after modifications, the penalty is subject to waiver if all other nonresident shareholders with positive income after modifications are included. However, the pass through entity must demonstrate that they did not list the owner because of the owner's zero or negative income after adjustments. Additionally, the pass through entity must provide the relevant information for such excluded owners upon request. A Schedule IN K-1 still must be provided to the owner and to the department for all owners even if the owner has a negative income after adjustments. In addition, failure to remit the composite tax due with the pass through entity's return may result in a 20% penalty of the tax not remitted by the pass through entity, even if the tax is remitted by the owners.

The composite schedule shall be due with the pass through entity's return. If the IRS allows the pass through entity an extension to file its federal income tax return, the corresponding due dates for its Indiana income tax returns are extended automatically for the same period, plus 30 days.

SAFE HARBOR PROVISION

A partnership or S corporation will not be penalized for failure to pay the full amount of tax shown on the return or to pay the deficiency of the withholding taxes due if the partnership or S corporation pays the department at least 80% of the withholding tax due for the current year or 100% of the withholding tax due for the preceding year before the 15th day of the 4th month after the end of the S corporation's taxable year. However, if the remaining unpaid tax and interest is not remitted by the extended due date for the partnership or S corporation return, late payment penalties may be assessed on the unpaid balance.

A partnership or S corporation permitted an extension of time to file its income tax return under [IC 6-8.1-6-1](#) will be granted the same extension for withholding if withholding only occurs once a year. However, in order to qualify

for penalty relief, the partnership or S corporation is required:

- (1) to meet the safe harbor provision set forth in the paragraph or otherwise pay 90% of the tax reasonably expected to be due by the due date of the pass through entity return prior to any extension; and
- (2) to remit any unpaid tax and interest by the extended due date.

An extension does not relieve the pass through entity for interest on any unpaid tax or penalty except as specifically provided by law.

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Commissioner

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