



Indiana Department of Revenue

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Income Tax Information Bulletin #72

Subject: S Corporation, Trust, and Partnership Mandate to File a Composite Return on Behalf of Nonresident Shareholders and Partners

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References: IC 6-3-2.1; 6-3-3-5; IC 6-3-4-12; IC 6-3-4-13; IC 6-3-4-15

Replaces Bulletin #72, dated March 2024

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Summary of Changes

Apart from nonsubstantive, technical changes, this bulletin has been revised to reflect that the revised computation of income subject to withholding and pass through entity tax (PTET) will be used for 2025 and later as opposed to 2024 and later. In addition, the safe harbor provision has been clarified to reflect the 90% safe harbor for tax reasonably expected to be due applies only if the entity elects to be subject to PTET.

As an additional clarifying matter, the prior version of this bulletin indicated in the summary of changes that the \$500 penalty for not listing all partners and shareholders on a composite return would not be imposed for 2023. The intended language was that the exception to the penalty applies solely to including partners and shareholders with zero or negative income and not to including partners and shareholders with positive income, and the language in the substantive text of the bulletins applies.

Introduction

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 with limited exceptions. 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, S corporation, estate, 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.

Income Inclusion for Pass Through Entity Tax and Withholding/Composite Tax

For 2022, the income computation provided in the IT-20S and IT-65 instruction booklets and Schedule IN K-1 shall be used.

Calculation for 2023 and 2024

For 2023 and 2024, the income used for composite withholding will be the sum of Schedule IN K-1, Part 3, lines 1 through 11 minus lines 12, 13a, and 13b, plus any modifications listed in Part 4. The modifications for Part 4 shall be listed in the instruction booklet. However, for individual owners, the amounts allowable on Part 3, lines 13a and 13b are the amounts allowable in determining federal adjusted gross income. If the computed amount of income is less than zero, the amount is zero.

If a nonresident individual owner is subject to a loss limitation (passive loss, at-risk loss, etc.), the owner must do one of the following:

1. File a Form IT-40PNR.
2. If no Form IT-40PNR for 2023 is filed, do not claim any limited federal loss (other than losses limited by basis limitations) on future Indiana tax returns that otherwise would have been claimed on the IT-40PNR. For a partner in a partnership, claiming a deduction in this situation will be considered an inconsistent reporting by the owner for purposes of IC 6-3-4.5.

For 2025 and later, if a pass-through entity has actual knowledge that all (or substantially all) owners are not subject to federal passive or at-risk loss limitations, the income shall be computed in the same manner as the 2023 and 2024 calculation with the following modifications:

1. If Part 3, line 8 and/or line 9 are less than zero, then line 8 plus line 9 cannot be less than zero unless the pass-through entity has a net positive capital gain (without consideration of any Section 1231 gain or loss).
2. The Part 3, line 12 Section 179 modification shall be limited to the amount added back in Part 4 (prior to any depreciation computed as part of the Indiana modification).
3. For individual owners, the amounts allowable on Part 3, lines 13a and 13b are the amounts allowable in determining federal adjusted gross income. Amounts allowable as itemized deductions are not permitted to be taken into account.

Any required modifications for 2025 and later will be reflected either by a line on Part 1 and/or a modification in Part 4 of Schedule IN K-1.

Standard method for 2025 and later

For purposes of determining the income subject to withholding in 2025 and later, the following rules will apply as a general rule. Any references to line numbers are to the Schedule IN K-1.

1. Ordinary income/loss from the pass-through entity that is attributed to the owner shall be included.
2. Other items of positive federal income shall be included.
3. Guaranteed payments for partners shall be included.
4. Capital losses shall be deductible only to the extent that either:
 - a. Capital losses do not exceed capital gains, or
 - b. In the case of a nonresident, either:
 - i. Federal capital losses for the partnership do not exceed federal capital gains from the partnership; or
 - ii. Indiana-source capital losses do not exceed Indiana-source capital gains.
 - c. A section 1231 loss shall not be considered a capital loss and a section 1231 gain shall not be considered a capital gain.
5. Loss items generally are permitted. However, if an entity has loss items that can be considered passive for federal income tax purposes (Schedule IN K-1, Part 3, lines 2, 3, 10, and 11), those losses are permitted as follows:
 - a. First, determine if the pass-through entity has positive federal adjusted gross income in aggregate for those lines. If yes, the losses are permitted in full.
 - b. Second, if the pass-through entity has negative federal adjusted gross income in aggregate for those lines, determine if the pass-through entity has positive federal adjusted gross income for each line individually. If the federal adjusted gross income associated with the line is positive, the loss for that line is permitted in full.
 - c. Third, after applying (b), if ordinary income (Part 3, line 1) is positive, then the losses for those lines are permitted to the extent of:
 - i. Line 1, plus
 - ii. The greater of any net Indiana modifications directly associated with the loss reported on those lines for the taxable year or \$0.
 - d. Fourth, after applying (b), if ordinary income (Part 3, line 1) is zero or negative, then the losses for those lines are permitted to the extent of the greater of any net

Indiana modifications directly associated with the losses reported on those lines for the taxable year or \$0.

6. The amount allowable as a deduction for Section 179 expensing shall be limited to the Section 179 modification required to be listed in Part 4, prior to any allowance for depreciation.

For individual partners, shareholders, and beneficiaries, only deductions allowable in determining adjusted gross income will be allowed. The Indiana modifications to adjusted gross income that are permitted to both individual and corporate taxpayers under IC 6-3-1-3.5 (including any modifications under IC 6-3-2) are permitted with the exception of modifications directly related to passive activities for which the entity has a loss and that, on net, would decrease adjusted gross income for the owner. Any required modifications for 2025 and later will be reflected either by a line on Part 1 and/or a modification in Part 4 of Schedule IN K-1.

Composite Return Limitations

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

- Any income for the owner shall be computed in the manner prescribed above.
- 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 2023 and later, these must be designated by the owner on Schedule COMP-A.
- No deduction shall be permitted for interest paid on investment indebtedness under IRC section 163(d) (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, if a 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 Dec. 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.

Special Rules for Part-Year Residents

If a pass-through entity has an individual that was a resident for part of the taxable year and was a nonresident for part of the taxable year, the pass-through entity shall withhold tax on:

- (1) the entire portion of the distributive share earned while an Indiana resident, plus
- (2) the Indiana portion of the distributive share earned while a resident of another state or country.

As a general rule, for a pass-through entity, the share attributable to each portion of the year should be prorated by day. For an estate or a trust, the share attributable to each portion should be determined on the day a distribution is made or deemed to be made. However, if a pass-through entity can establish a different attribution (e.g., a seasonal business), the pass-through entity may use the different attribution. In addition, if the pass-through entity cannot divide the owner's income, the entity can treat the owner as a full-year nonresident.

In addition, if the individual was a resident of an Indiana county on January 1, the entire distributive share is subject to local income tax. If the individual was a resident of a county outside Indiana on January 1, the distributive share is not subject to income tax except as specifically provided in this bulletin.

Composite Filing Procedures

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

- (1) If the entity either has elected to be subject to pass through entity tax (PTET) or is passing through PTET paid by another entity and the entity's PTET for each owner required to be listed on Schedule Composite is greater than the state tax computed on Schedule

Composite, you may check the box on Schedule PTET to not file a composite return. Schedule PTET will serve as the composite return. This also applies to the requirement to file Schedule Composite-COR, if PTET is indicated.

However, you must file Schedule Composite if any nonresident owner is subject to county income tax. In addition, you must file Schedule Composite and/or Schedule Composite COR if the state composite tax computed would exceed the PTET paid for any nonresident owner except for the application of an exception code.

The requirements to file Schedule Composite and Schedule Composite-COR are determined separately for each schedule. In other words, a pass-through entity may be permitted to not file a Schedule Composite but may be required to file a Schedule Composite-COR.

- (2) 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 corporation generally is not subject to tax (e.g., a charitable organization) **and** the income is known to not be unrelated business income.

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).

If the entity is reporting PTET for an owner, the Indiana tax liability for each nonresident owner is reduced by the amount of PTET reported for that owner. PTET cannot reduce Indiana county tax liability.

NOTE: For a partnership or S corporation, composite income means each nonresident owner's distributive share of income, as determined above.

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.

S corporations are not required to list nonprofit corporations on Schedule Composite.

- (3) 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 composite tax due amount. Nonrefundable credits are not permitted against PTET.
- (4) Insert the total amount paid with Form IT-6WTH on behalf of the nonresident owners included in the composite return, on the line for total IT-6WTH 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. This line is also used for reporting PTET payments. If you are reporting both PTET and composite withholding, the amounts will be combined.
- (5) Any balance due or overpayment reported as a result is to be remitted by or refunded to the pass-through entity.

If there is a reason for not withholding or withholding a reduced amount on a partner, shareholder, or beneficiary, indicate the applicable exception code on the Schedule Composite or Schedule Composite-COR. These exceptions must be determined on a recipient-by-recipient basis. Please see the instructions for Schedule Composite or Schedule Composite-COR for the relevant codes.

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 fourth month following the close of the pass-through entity's tax period. Multiple payments and IT-6WTH vouchers may be filed throughout the tax year or during the extension period. If additional payments are necessary, remit using the department's online e-services portal, the Indiana Taxpayer Information Management Engine (INTIME), which can be accessed at intime.dor.in.gov.

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, for taxable years beginning in 2023 and earlier, if an owner has

a zero or negative income after modifications, do **not** include the owner on a composite return unless you are reflecting pass through entity tax that is credited to the owner. A penalty of \$500 is imposed on a partnership or S corporation that fails to file a composite return that includes all nonresident owners.

If the composite return otherwise would include an owner with zero or negative income after modifications, the penalty is subject to waiver if all other nonresident owners 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.

Starting with the 2024 tax year, the composite return filed on paper must include nonresident owners with zero or negative income after modifications. Failure to include nonresident owners will be subject to a \$500 penalty. The failure to include nonresident owners with zero or negative income will **not** be subject to penalty for taxable years that begin during 2023. However, composite returns will be subject to penalty for failure to include nonresident owners with zero or negative income after modifications starting with taxable years that file a return for tax year 2024 or later.

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 return 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 one month.

If a pass-through entity makes a payment in intended compliance with PTET but does not make a PTET election, those payments will be recharacterized as withholding tax payments.

Withholding on Nonresident Individual Partners and Shareholders Who Are Domiciled in a Reverse Credit State

A partnership is required to withhold on distributions or amounts credited to nonresident partners. S corporations are required to withhold on distributions or amounts credited to nonresident shareholders. The partnership or S corporation becomes liable to the State of Indiana for the payment of this tax and must report it as statutorily required. The nonresident partner or shareholder must file the appropriate tax return to claim credit for the taxes withheld.

A unique situation occurs when a nonresident individual partner or shareholder is domiciled in a reverse credit state with a higher tax rate than Indiana's. These individuals may claim credit on their Indiana nonresident return for taxes paid to their state of domicile on Indiana source income. Since the domiciliary state imposes a higher tax rate, such individuals will normally not owe any tax to the State of Indiana.

The withholding of taxes as described in this section of the bulletin is not required when a nonresident individual partner or shareholder is domiciled for the entire year in a reverse credit state when a higher tax rate than the tax rate in effect in Indiana for that tax year and the Indiana source income is actually taxed in the domiciliary state. If the tax rate in the domiciliary state is lower than Indiana's tax rate, such as Arizona, the withholding is the difference between Indiana's state tax rate and the domiciliary state's tax rate.

Special Rules for Owners Without a Federal Identification Number

If an owner does not have an FEIN, an Individual Taxpayer Identification Number, or Social Security Number, you are required to list the owner on the composite return. For 2023, you will be required to:

1. List the owner without a federal ID number, leaving the federal ID column blank;
2. List the owner's state of residence as "FC"; and
3. File any Schedule IN K-1s on paper. If applicable, the \$10 penalty per paper K-1 will not be due under this circumstance. If the penalty is imposed, contact the department at 317-232-0129 for waiver of the penalty.

Safe Harbor Provision

A partnership or S corporation will not be penalized for failure to pay the full amount of composite withholding tax shown on the return or to pay the deficiency of the PTET due if the partnership or S corporation pays the department at least 80% of the combined PTET and composite withholding tax due for the current year or 100% of the combined PTET and composite withholding tax due for the preceding year before the 15th day of the fourth month after the end of the partnership or 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 composite withholding tax. 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 section or otherwise pay 90% of the combined PTET and composite withholding tax (if the partnership or S Corporation elects to be subject to PTET) 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.

If you have any questions concerning this bulletin, contact the Tax Policy Division at taxpolicy@dor.in.gov.

A handwritten signature in black ink that reads "Robert J. Grennes, Jr." in a cursive style.

Robert J. Grennes, Jr.
Commissioner
Indiana Department of Revenue