

12-1-1997

## REVENUE AND TAXATION Income Taxes: Provide for Non Income Taxation and No Withholding Tax on the Distributive Share of a Nonresident Member of a Resident Limited Partnership Which Derives Income Exclusively from Buying, Selling, Dealing in, and Holding Securities on its Own Behalf

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### Recommended Citation

Assunta Deevey, *REVENUE AND TAXATION Income Taxes: Provide for Non Income Taxation and No Withholding Tax on the Distributive Share of a Nonresident Member of a Resident Limited Partnership Which Derives Income Exclusively from Buying, Selling, Dealing in, and Holding Securities on its Own Behalf*, 14 GA. ST. U. L. REV. (1997).

Available at: <https://readingroom.law.gsu.edu/gsulr/vol14/iss1/5>

## REVENUE AND TAXATION

***Income Taxes: Provide for No Income Taxation and No Withholding Tax on the Distributive Share of a Nonresident Member of a Resident Limited Partnership Which Derives Income Exclusively from Buying, Selling, Dealing in, and Holding Securities on its Own Behalf***

CODE SECTIONS: O.C.G.A. §§ 48-7-23 to -24, -129 (amended)  
BILL NUMBER: HB 241  
ACT NUMBER: 48  
GEORGIA LAWS: 1997 Ga. Laws 450  
SUMMARY: The Act provides for changes in the income taxation of nonresident members of resident limited partnerships. A nonresident member of a resident limited partnership which derives income exclusively from buying, selling, dealing in, or holding securities on its own behalf, not as a broker, is not required to include on his or her individual return his or her distributed shares, whether distributed or not, of the net income of the partnership for the taxable year. Such net income is not considered taxable income. The same type of nonresident member of a resident limited partnership is also not subject to a withholding tax.

EFFECTIVE DATE: April 14, 1997<sup>1</sup>

### *History*

The economic development and security of Georgia are of paramount concern to Georgia legislators.<sup>2</sup> By protecting businesses in Georgia and by creating incentives for other businesses to come to the state, the General Assembly can protect and create jobs and provide security for Georgia residents.<sup>3</sup> Many states that border Georgia entice business by granting them economic benefits.<sup>4</sup> Some legislators believe that Georgia

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1. The Act became effective upon approval by the Governor and is applicable to all taxable years beginning after January 1, 1997.

2. See Telephone Interview with Rep. Ben Harbin, House District No. 113 (Apr. 24, 1997) [hereinafter Harbin Interview].

3. See *id.*

4. See Harbin Interview, *supra* note 2; see also Interview with Rep. Burke Day, House District No. 153 (Apr. 25, 1997) [hereinafter Day Interview].

must also offer businesses benefits in order to stay competitive and attractive to foreign investors.<sup>5</sup>

HB 241 creates an incentive to invest in Georgia-based venture capital partnerships (resident limited partnerships that earn income from dealing in securities on their behalf) by eliminating an out-of-state investor's tax liability on any derivative profits from the Georgia venture.<sup>6</sup> This incentive was considered vital because many of Georgia's surrounding states already incorporated comparable tax relief for nonresident investors.<sup>7</sup> Therefore, the bill was needed to allow Georgia to compete with bordering states for investors and to stimulate growth of new companies.<sup>8</sup>

### HB 241

Prior to the enactment of HB 241, Code section 48-7-24 provided that all nonresident members of partnerships that do business in Georgia shall be taxed on their distributive share of the resident partnership's net profits.<sup>9</sup> HB 241 carves out an exception to this rule.<sup>10</sup> A nonresident member of a partnership will now be exempt from paying income tax on the amount of that member's distributive share.<sup>11</sup> That exception, however, is only applicable to such partnerships that derive

5. See Harbin Interview, *supra* note 2; see also Day Interview, *supra* note 4.

6. See O.C.G.A. § 48-7-24(c) (Supp. 1997). Derivative profit is income earned by the partnership entity which is then passed through to the partners as profit. Partnership entities are not themselves subject to income tax. Any gains or losses of the partnership entity are not taxed at the partnership level. Instead, realization of such gain or loss is passed through the partnership and distributed to the persons carrying on business as partners. Each partner is then liable, in his or her individual capacity as a partner, for the income tax generated by the gain or loss, and each partner must report such gain or loss on his or her individual tax return. Each partner's allocation of gain or loss (that partner's distributive share) is generally determined by the partnership agreement, or if not provided for in the partnership agreement, in accordance with the partner's interest in the partnership. See generally WILLIAM A. GREGORY & THOMAS R. HURST, AGENCY AND PARTNERSHIP 411-14 (1994).

7. See Harbin Interview, *supra* note 2 (mentioning Alabama and South Carolina); see also Day Interview, *supra* note 4 (mentioning North Carolina).

8. See Harbin Interview, *supra* note 2; see also Day Interview, *supra* note 4.

9. 1931 Ga. Laws Ex. Sess. 24, § 19, at 39 (formerly found at O.C.G.A. § 48-7-24(a) (1995)). A "nonresident member" is a person or entity who does not have a personal residence or principal place of business within the state of Georgia but is a member of the partnership at issue. See BLACK'S LAW DICTIONARY 1057 (6th ed. 1990). A "resident limited partnership" is a partnership interest that has its principal place of business within the state of Georgia and has one or more general partners who manage the business and one or more limited partners who contribute capital but do not take part in managing the business. See *id.* at 928, 1309.

10. HB 241 (HCS), 1997 Ga. Gen. Assem.

11. O.C.G.A. § 48-7-24(c) (Supp. 1997).

their income solely from buying, selling, dealing in, or holding securities on their own behalf within the state of Georgia.<sup>12</sup>

### *Introduction*

As a result of the Act, nonresident members of resident limited partnerships will not be taxed on their portion of the partnership's net income.<sup>13</sup> Although this means a temporary loss of tax revenue for the state, it also protects such nonresident members from the high cost of doing business in Georgia.<sup>14</sup> By protecting these nonresident members, the General Assembly intended to encourage such partnership interests to invest in Georgia, create jobs, and stimulate the economy. Therefore, the risk of loss in tax revenue is offset by the rise in the number of foreign investors who will find Georgia an attractive state in which to do business.<sup>15</sup>

### *Nontaxable Income*

The Act creates a new subsection at the end of Code section 48-7-24.<sup>16</sup> The new subsection clearly creates an exception to Code section 48-7-23, which allows for income taxation on each individual's distributive share earned by a business partnership.<sup>17</sup> New subsection (c) allows for the distributive share of an individual who lives out-of-state to be nontaxable income if it is earned by a partnership residing in Georgia and earning income solely from buying, selling, dealing in, and holding securities exclusively on its own behalf.<sup>18</sup>

### *Eliminating Withholding Tax*

The Act amends Code section 48-7-129 to eliminate the withholding tax on the distributive share of the nonresident members.<sup>19</sup> Withholding taxes are deductions made from wages to employees for income tax or social security purposes.<sup>20</sup> These sums are then remitted from the taxpayer to the taxing authority.<sup>21</sup>

12. *Id.*

13. *Id.*

14. See Day Interview, *supra* note 4.

15. See *id.*

16. O.C.G.A. § 48-7-24(c) (Supp. 1997).

17. 1931 Ga. Laws Ex. Sess. 24, § 7, at 28-29 (formerly found at O.C.G.A. § 48-7-23 (1995)).

18. O.C.G.A. § 48-7-24(c) (Supp. 1997).

19. 1993 Ga. Laws 597, § 3, at 598-602 (formerly found at O.C.G.A. § 48-7-129 (1995)); O.C.G.A. § 48-7-129(a)(1) (Supp. 1997).

20. See BLACK'S LAW DICTIONARY 1602 (6th ed. 1990).

21. See *id.*

By eliminating the income tax on the distributive share of nonresident members of certain resident limited partnerships, the responsibility of withholding such income taxes is also eliminated.<sup>22</sup> This is effected by creating an exception to the Code section that subjects general partnerships, "S" corporations, and limited liability companies to withholding tax.<sup>23</sup> The amended Code section provides that, "[s]uch tax shall be withheld from any distributions paid or credited to members who are not residents of Georgia, *except as provided in subsection (c) of Code section 48-7-24.*"<sup>24</sup> Code section 48-7-24(c) refers to the new subsection previously discussed that eliminates taxable income treatment on nonresident members.<sup>25</sup>

### *Committee Amendments*

The House Ways and Means Committee made several changes to the original version of HB 241. Some of the changes were procedural and others substantive.<sup>26</sup>

### *Procedural Amendments*

The House Committee made several procedural corrections to the original version of HB 241.<sup>27</sup> The first change, although minor, had a significant impact. The original version of the bill stated: "the distributive share of a nonresident member of a resident limited partnership . . . shall constitute taxable income."<sup>28</sup> Because the purpose of the legislation is to provide a tax incentive or relief to certain members of resident limited partnerships, the Committee made a change to correct the error.<sup>29</sup> The amended version states: "the distributive share of a nonresident member of a resident limited partnership . . . shall *not* constitute taxable income."<sup>30</sup>

Another procedural change offered by the House Committee referred to the effective date of the Act.<sup>31</sup> The legislation originally provided for the Act to be effective on January 1, 1998.<sup>32</sup> The Committee substitute

22. See O.C.G.A. §§ 48-7-24(c), -129(a)(1) (Supp. 1997).

23. See HB 241 (HCS), 1997 Ga. Gen. Assem.

24. See *id.* The emphasis denotes the additional language added to Code section 48-7-129 by HB 241. See *id.*

25. O.C.G.A. § 48-7-24(c) (Supp. 1997).

26. Compare HB 241, as introduced, 1997 Ga. Gen. Assem. with HB 241 (HCS), 1997 Ga. Gen. Assem.

27. HB 241 (HCS), 1997 Ga. Gen. Assem.

28. HB 241, as introduced, 1997 Ga. Gen. Assem.

29. See Harbin Interview, *supra* note 2.

30. O.C.G.A. § 48-7-24(c) (Supp. 1997) (emphasis added).

31. HB 241 (HCS), 1997 Ga. Gen. Assem.

32. HB 241, as introduced, 1997 Ga. Gen. Assem.

states that “[t]his Act shall become effective upon its approval by the Governor or upon its becoming law without such approval and shall be applicable to all taxable years beginning on or after January 1, 1997.”<sup>33</sup>

### *Substantive Amendments*

The House Committee added some additional language to the initial version regarding Code section 48-7-24.<sup>34</sup> First, the Committee added the words “or other similar nontaxable entity.”<sup>35</sup> These words were added in the context of defining a resident limited partnership.<sup>36</sup> This additional language refers to a business group, not necessarily in partnership form, that derives income from buying, selling, dealing in, and holding securities on its own behalf, not as a broker.<sup>37</sup> This provision provides relief from tax liability for nonresident members who want to invest in any type of Georgia entity that derives its income as proscribed.<sup>38</sup>

The House Committee also added language to the new subsection, which specifically excluded family limited partnerships from the tax relief.<sup>39</sup> After outlining the new tax measure, the Committee added the language “[f]or purposes of this subsection, a resident limited partnership shall not include a family limited partnership the majority interest of which is owned by one or more natural or naturalized citizens related to each other within the fourth degree of reckoning according to the laws of descent and distribution.”<sup>40</sup>

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33. HB 241 (HCS), 1997 Ga. Gen. Assem.

34. Compare HB 241, as introduced, 1997 Ga. Gen. Assem. with HB 241 (HCS), 1997 Ga. Gen. Assem.

35. HB 241 (HCS), 1997 Ga. Gen. Assem.

36. See *id.*

37. See *id.*

38. See *id.*

39. *Id.*

40. *Id.*