
Session One:

Compliance of Large Business Entities



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Partnerships with Reportable Entity Partners

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The opinions expressed are those of the authors and do not necessarily reflect positions of the IRS or U.S. Department of the Treasury.

Research Question

If a partnership is 50% or more owned by a corporation or partnership, how are key tax characteristics of the owned partnership related to key characteristics of the owning corporation or partnership?

Why?

- The number of partnerships is growing
 - 2005 2,763,625
 - 2006 2,947,116
 - 2007 3,096,334
- Partnerships may be organized as complex tiers of partnerships
- Partnerships are used as substitutes for corporate subsidiaries
 - Partnerships offer great flexibility in allocating income and loss within complex organizations
 - Partnerships offer the opportunity to move the details of transactions onto a separate income tax return

Key tax characteristics of the owned partnership:

- Total Assets
- Industry (NAICS code)
- Tax Income
 - Positive Tax Income
 - Negative Tax Income
- M-3 Book-Tax Difference (BTD)
 - $BTD = \text{Tax Income} - \text{Book Income}$
 - $BTD \leq 0$ (negative) if $\text{Book Income} \geq \text{Tax Income}$
 - $BTD > 0$ (positive) if $\text{Tax Income} > \text{Book Income}$

Key tax characteristics of the owning corporation or partnership

- Tax Return Type
 - Form 1120 corporation
 - Form 1120-S corporation
 - Form 1065 partnership
- Total Assets
- Industry (NAICS code)

Schedule M-3 Reconciliation Form

- Reconciles financial statement income (“Book”) with tax return income
- Applies to corporations and partnerships with assets of \$10 million or more
- M-3 also applies to partnerships with
 - Adjusted Total Assets of \$10 million or more
 - Total Receipts of \$35 million or more
 - Any Reportable Entity Partner (REP)

What is a Reportable Entity Partner (REP)?

- A Reportable Entity Partner (REP) is a corporation or partnership itself required to file Schedule M-3 that owns, directly or indirectly, 50% or more of a partnership's profit, loss, or capital.
 - A partnership with a REP must file Schedule M-3 even if it would not otherwise be required.
 - A partnership with a REP must identify the REP on the partnership M-3 by name, EIN, and maximum ownership percentage of profit, loss, or capital.

REP Deemed Indirect Ownership

- In general, an entity which owns 50% or more of another entity is deemed to own all corporate and partnership interests owned by that owned entity.
- A tax consolidated parent corporation is deemed to own all corporate and partnership interests owned by a subsidiary.

Steps in Identifying REP Data

- Extract REP EINs from the 2007 SOI Partnership File.
 - The 2007 SOI file is statistically designed to describe all processing year (PY) 2008 partnerships.
- Search for REP EIN in return files for forms 1065, 1065-B, 1120-S, 1120, 1120-PC, 1120-L, 1120-C, and 1120-F.
- Search Form 851 parent-subsubsidiary files if EIN is not in return files and replace subsidiary EIN with parent EIN.
- Extract return type, tax period, total assets, and industry NAICS code from return files for final identified REP EIN.
- Replace return file NAICS with SOI NAICS if different.

On the next three slides note

- 190,711 partnerships with M-3 required and present report 88.6% of all partnership assets, 69.3% of negative tax income, 80.8% of positive tax income, and essentially all book-tax difference (BTD).
- 63,847 partnerships with a REP report 22.7% of all partnership assets, 26.2% of negative tax income, 16.8% of positive tax income, 22.1% of negative BTD, and 20.5% of positive BTD.

All Partnerships: Total Returns and Assets by M-3 Status, 2007(\$ millions)

M-3 Status	Returns	Assets	Returns %	Assets %
Not Required Not Present	2,882,188	1,942,739	93.1%	9.5%
Not Required but Present	16,536	29,828	.5%	.1%
Required but Not Present	6,900	354,084	.2%	1.7%
Subtotal Not Required or Not Present	2,905,623	2,326,651	93.8%	11.4%
No REP	120,637	12,231,250	3.9%	60.0%
REP	63,847	4,626,270	2.1%	22.7%
REP without a Match	6,226	1,201,964	.2%	5.9%
Subtotal Required and Present	190,711	18,059,483	6.2%	88.6%
Total All Returns	3,096,334	20,386,134	100.0%	100.0%

M-3 is treated as "Not Present" if both book income and tax income are zero.

All Partnerships: Total Returns and Tax Income by M-3 Status, 2007(\$ millions)

M-3 Status	Negative Tax Income				Positive Tax Income			
	Returns	Sum	Returns %	Sum %	Returns	Sum	Returns %	Sum %
Not Required Not Present	1,257,279	(98,444)	92.8%	28.5%	1,624,909	326,976	93.3%	17.6%
Not Required but Present	9,262	(4,955)	0.7%	1.4%	7,274	8,064	0.4%	0.4%
Required but Not Present	3,164	(2,535)	0.2%	0.7%	3,736	22,166	0.2%	1.2%
Subtotal Not Required or Not Present	1,269,705	(105,934)	93.7%	30.7%	1,635,919	357,206	93.9%	19.2%
No REP	45,245	(142,073)	3.3%	41.1%	75,392	1,115,849	4.3%	60.1%
REP	37,104	(90,435)	2.7%	26.2%	26,744	311,756	1.5%	16.8%
REP without a Match	2,517	(7,073)	0.2%	2.0%	3,709	72,308	0.2%	3.9%
Subtotal Required and Present	84,865	(239,581)	6.3%	69.3%	105,845	1,499,913	6.1%	80.8%
Total All Returns	1,354,570	(345,515)	100.0%	100.0%	1,741,764	1,857,119	100.0%	100.0%

All Partnerships: Total Returns and Book Tax Difference by M-3 Status, 2007(\$ millions)

M-3 Status	Negative Book Tax Difference*				Positive Book Tax Difference			
	Returns	Sum	Returns %	Sum %	Returns	Sum	Returns %	Sum %
Not Required Not Present	2,882,188	0	95.5%	0.0%	0	.	0.0%	0.0%
Not Required but Present	9,083	(1,195)	0.3%	0.3%	7,453	2,717	9.3%	0.8%
Required but Not Present	6,900	0	0.2%	0.0%	0	.	0.0%	0.0%
Subtotal Not Required or Not Present	2,898,170	(1,195)	96.1%	0.3%	7,453	2,717	9.3%	0.8%
No REP	73,135	(301,112)	2.4%	73.9%	47,502	266,643	59.5%	74.9%
REP	41,733	(89,924)	1.4%	22.1%	22,114	72,790	27.7%	20.5%
REP without a Match	3,517	(15,241)	0.1%	3.7%	2,709	13,654	3.4%	3.8%
Subtotal Required and Present	118,385	(406,277)	3.9%	99.7%	72,325	353,087	90.7%	99.2%
Total All Returns	3,016,555	(407,472)	100.0%	100.0%	79,779	355,805	100.0%	100.0%

*Note: Zero Book Tax Difference (BTD) returns reported in negative BTD column.

On the next six slides note the importance of

- REP with \$5 billion or more in assets
 - 13.8% of partnerships with a REP report under \$10 million in assets and have a REP reporting \$5 billion or more in assets
- REP filing corporation Form 1120
- REP in Finance/Holding industry
- Partnerships with \$250 million or more in assets
- Partnerships in Finance/Holding industry
- And note an anomaly
 - 119 partnership report \$250 million or more in assets and have a REP reporting less than \$10 million in assets

Partnerships with REP: 2007 Total Returns (% All) and Assets (% All): Partnership Asset Size by REP Asset Size

Partnership Assets Size	REP Asset Size							
	Under \$10M		\$10M < \$5B		\$5B and up		Total	
	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets
Under \$10M	14.5%	.4%	44.7%	1.6%	13.8%	.3%	73.0%	2.3%
\$10M < \$250M	3.2%	1.6%	16.6%	10.8%	4.5%	3.7%	24.3%	16.0%
\$250M and up	.2%	3.3%	1.4%	21.3%	1.2%	57.1%	2.8%	81.7%
Total	17.8%	5.2%	62.7%	33.7%	19.5%	61.1%	100.0%	100.0%

Note: In 2007, 63,847 partnerships with an identified REP report total assets of \$4,626,270 million.

Partnerships with REP: 2007 Total Returns (% All) and Assets (% All): Partnership Asset Size by REP Return Type

Partnership Asset Size	REP Return Type							
	Form 1065		Form 1120		Form 1120S		Total	
	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets
Under \$10M	41.7%	1.5%	24.9%	.6%	6.4%	.2%	73.0%	2.3%
\$10M < \$250M	15.3%	9.5%	7.7%	5.8%	1.3%	.8%	24.3%	16.0%
\$250M and up	1.3%	32.8%	1.4%	47.3%	.1%	1.6%	2.8%	81.7%
Total	58.3%	43.7%	34.0%	53.7%	7.8%	2.6%	100.0%	100.0%

Note: In 2007, 63,847 partnerships with an identified REP report total assets of \$4,626,270 million.

Partnerships with REP: 2007 Total Returns (% All) and Assets (% All): Partnership Asset Size by REP Industry

Partnership Asset Size	REP Industry											
	Finance/Holding		Real Estate/Rental		Manufacturing		Information		Other		Total	
	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets
Under \$10M	21.3%	.8%	33.8%	1.2%	2.2%	.1%	1.1%	-0.20%	14.6%	.4%	73.0%	2.3%
\$10M < \$250M	7.3%	5.8%	10.6%	5.7%	1.3%	1.1%	.7%	.4%	4.3%	3.0%	24.3%	16.0%
\$250M and up	1.2%	49.3%	.4%	4.8%	.4%	9.4%	.2%	10.2%	.5%	8.1%	2.8%	81.7%
Total	29.8%	55.8%	44.9%	11.7%	3.9%	10.6%	1.9%	10.4%	19.5%	11.5%	100.0%	100.0%

Note: In 2007, 63,847 partnerships with an identified REP report total assets of \$4,626,270 million.

Partnerships with REP: 2007 Total Returns (% All) and Assets (% All): Partnership Industry by REP Asset Size

Partnership Industry	REP Asset Size							
	Under \$10M		\$10M < \$5B		\$5B and up		Total	
	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets
Finance/Holding	2.1%	3.2%	8.1%	16.0%	5.0%	37.9%	15.1%	57.1%
Real Estate/Rental	12.0%	1.2%	36.7%	9.5%	10.3%	4.2%	58.9%	14.9%
Manufacturing	.1%	.2%	1.3%	2.1%	.3%	3.9%	1.8%	6.1%
Information	.8%	.1%	.4%	.4%	1.2%	9.3%	2.4%	9.8%
Construction	.6%	.1%	5.1%	.8%	.3%	.7%	6.0%	1.5%
Retail/Wholesale	.2%	.1%	1.5%	.8%	.2%	.9%	2.0%	1.8%
All Other	2.0%	.4%	9.6%	4.1%	2.3%	4.2%	13.9%	8.7%
Total	17.8%	5.2%	62.7%	33.7%	19.5%	61.1%	100.0%	100.0%

Note: In 2007, 63,847 partnerships with an identified REP report total assets of \$4,626,270 million.

Partnerships with REP: 2007 Total Returns (% All) and Assets (% All): Partnership Industry by REP Return Type

Partnership Industry	REP Return Type							
	Form 1065		Form 1120		Form 1120S		Total	
	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets
Finance/Holding	9.2%	28.7%	5.6%	27.1%	.3%	1.3%	15.1%	57.1%
Real Estate/Rental	39.7%	10.2%	15.5%	4.3%	3.7%	.3%	58.9%	14.9%
Manufacturing	.4%	1.0%	.9%	4.9%	.4%	.2%	1.8%	6.1%
Information	.8%	.2%	1.5%	9.5%	.1%	.1%	2.4%	9.8%
Construction	3.3%	.4%	1.6%	.9%	1.0%	.2%	6.0%	1.5%
Retail/Wholesale	.4%	.6%	.9%	1.0%	.6%	.2%	2.0%	1.8%
All Other	4.4%	2.6%	8.0%	5.9%	1.5%	.2%	13.9%	8.7%
Total	58.3%	43.7%	34.0%	53.7%	7.8%	2.6%	100.0%	100.0%

Note: In 2007, 63,847 partnerships with an identified REP report total assets of \$4,626,270 million.

Partnerships with REP: 2007 Total Returns (% All) and Assets (% All): Partnership Industry by REP Industry

Partnership Industry	REP Industry											
	Finance/Holding		Real Estate/Rental		Manufacturing		Information		Other		Total	
	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets	Returns	Assets
Finance/Holding	12.7%	50.9%	.7%	.4%	.4%	2.9%	.0%	.5%	1.4%	2.3%	15.1%	57.1%
Real Estate/Rental	13.4%	2.3%	40.0%	10.6%	1.1%	.7%	.1%	.3%	4.3%	.9%	58.9%	14.9%
Manufacturing	.2%	.8%	*	*	1.1%	4.6%	*	*	.3%	.7%	1.8%	6.1%
Information	.8%	.2%	*	*	*	*	1.6%	9.2%	.0%	.2%	2.4%	9.8%
Construction	.7%	.1%	2.0%	.3%	*	*	*	*	3.3%	1.2%	6.0%	1.5%
Retail/Wholesale	.4%	.2%	.1%	.0%	.4%	.3%	.0%	.0%	1.0%	1.3%	2.0%	1.8%
All Other	1.6%	1.4%	2.1%	.4%	.8%	1.7%	.2%	.3%	9.2%	5.0%	13.9%	8.7%
Total	29.8%	55.8%	44.9%	11.7%	3.9%	10.6%	1.9%	10.4%	19.5%	11.5%	100.0%	100.0%

Note: In 2007, 63,847 partnerships with an identified REP report total assets of \$4,626,270 million.

In Closing

- Reportable Entity Partner reporting offers insight into the growing business practice of using effectively controlled partnerships as substitutes for corporate subsidiaries and as building blocks in constructing complex economic organizations.
- Particularly interesting is the magnitude of partnership assets effectively controlled by large corporations (assets \geq \$5 billion), many in the Finance/Holding industry. Such effectively controlled partnerships are of every size and in every industry.
- Further research is warranted.

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- The Statistics of Income Division (SOI) for permission to use the 2007 SOI partnership data file
- The many reviewers with thoughtful comments