



Guideline

Income Tax Adjustment for Income (Loss) From A Pass- Through Entity Subject to N.D.C.C. ch. 57-35.3

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Introduction

This guideline applies to an individual, estate or trust that owns an interest in and derives income or a loss from an S corporation, partnership, or limited liability company (LLC) that files Form 35, the North Dakota financial institution tax return under N.D.C.C. ch. 57-35.3. In the case of an LLC, the adjustment applies only if the LLC is treated like a partnership or S corporation for federal income tax purposes. It explains the adjustment required to remove the income or loss from the computation of the North Dakota taxable income of the individual, estate or trust. The purpose of the adjustment is to prevent the income from being taxed twice, or the loss from being deducted twice, for North Dakota tax purposes—first, on the financial institution tax return of the passthrough entity and, second, on the income tax return of the entity's owners. Throughout the remainder of this guideline, an S corporation, partnership or LLC will be referred to as a passthrough entity.

If uncertain about whether a passthrough entity is required to file North Dakota Form 35, the individual, estate or trust should contact the passthrough entity. See **Member Statement** later in this guideline for more information.

Adjustment amount

The adjustment amount is equal to the distributive share of the passthrough entity's North Dakota income or loss for financial institution tax purposes with certain modifications. The modifications are required to remove certain adjustments that the passthrough entity made in determining its North Dakota income or loss that only affect the passthrough entity's financial institution tax liability. If there are modifications, or if the passthrough entity does not allocate and apportion 100 percent of its net income or loss to North Dakota for financial institution tax purposes, the adjustment amount will differ from the amount of income or loss reported on the federal income tax return by the individual, estate, or trust.

The adjustment amount will decrease or increase the North Dakota taxable income of the individual, estate, or trust owner depending on whether the passthrough entity has a net income or loss, respectively, for North Dakota financial institution tax purposes. See **How to report adjustment amount** later in this guideline for more information.

Determination of adjustment amount by passthrough entity. The passthrough entity must determine the adjustment amount for each individual, estate, or trust holding an interest in the passthrough entity's earnings or losses. It must provide this information to them at the end of each calendar year. See **Member Statement** later in this guideline for more information.

Note to passthrough entity: Instructions on how to calculate the adjustment amount are contained in the instructions to Form 35.

28219 (April 2008)

Member statement

The passthrough entity must provide each individual, estate or trust holding an interest in the passthrough entity's earnings or losses with a statement containing the following:

- Name, address, and federal employer identification number of the passthrough entity.
- Calendar year for which the statement is provided.
- The adjustment amount, identified as "N.D.C.C. ch. 57-35.3 adjustment," for the individual, estate or trust.
- Instructions to the individual, estate or trust explaining the purpose of the statement and containing a reference to this guideline.

The member statement must be prepared and given to each individual, estate or trust on or before the due date or extended due date of the North Dakota Form 35. The individual, estate or trust must keep the member statement to support the adjustment made on the return.

Alternative to member statement. As an alternative to providing a separate member statement, the passthrough entity may report the information required to be included in the member statement in the supplemental information section of the Federal Schedule K-1 that it provides to each individual, estate or trust. The information must be clearly identified as North Dakota tax information, with an instruction that it is important to the preparation of the member's North Dakota income tax return.

How to report adjustment amount

In the case of a nonresident individual, estate, or trust only, if the only income or loss derived from North Dakota sources is its distributive share of income or loss from a passthrough entity that files Form 35, the individual, estate, or trust does not have to file a North Dakota income tax return. If this applies, this portion of the guideline does not apply.

The adjustment amount must be reported for North Dakota income tax purposes in the same tax year in which the individual, estate or trust reports its distributive share of the passthrough entity's income or loss on its federal income tax return. In the case of an individual, the adjustment amount must be reported on the appropriate line of Form ND-1 or Form ND-2. In the case of an estate or trust, the adjustment amount must be reported on the appropriate line of Form 38, Schedule 1 or Schedule 2.

Income adjustment. If the adjustment amount is positive (i.e., it consists of the passthrough of net income), it must be subtracted from federal taxable income in determining North Dakota taxable income, but only to the extent it increased federal taxable income. In this case, enter the adjustment amount as a subtract adjustment on the applicable return.

Loss adjustment. If the adjustment amount is negative (i.e., it consists of the passthrough of a loss), it must be added to federal taxable income in determining North Dakota taxable income, but only to the extent the loss reduced federal taxable income. In this case, enter the adjustment amount as an addition adjustment on the applicable return.

Need help?

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