

## Revisiting State Sourcing Rules for Sales of Partnership Interests

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In this article, the authors provide their perspective on understanding common state sourcing rules for the sale of partnership interests for nonresident partnership partners.

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According to a December 2025 *Private Equity International* article,<sup>1</sup> many private equity firms are experiencing a slowdown in fundraising activity. That recent industry trend has prompted some general partners to sell significant amounts of their equity interests.

In a typical private equity partnership structure, general partners — often organized as limited liability companies — contribute minimal capital primarily to demonstrate their commitment to the performance of the funds they manage. In general, those LLCs are treated as partnerships for federal and state tax purposes, and individual partners generally own those general partner entities.

In the *Private Equity International* article, one general partner noted that limited partners are increasingly demanding larger capital commitments from general partners. Considering that development, when realized gains arise from the sale of partnership interests, it becomes

essential to examine how states source those gains in the context of noncorporate partners in a multistate partnership.

This article explores that trend and outlines the most common state sourcing methods and some key state updates.

### Federal Background

In 1991 the IRS issued Rev. Rul. 91-32, 1991-1 C.B. 107, which concluded that when a foreign partner disposes of an interest in a U.S. partnership, the resulting gain should be computed as if the partnership itself had sold its underlying assets. However, in *Grecian Magnesite Mining, Industrial & Shipping Co.*,<sup>2</sup> the U.S. Tax Court declined to defer to Rev. Rul. 91-32. The court held that because Congress had not enacted a specific aggregate rule for determining the source and character of gain on a foreign partner's disposition of a partnership interest, the general rule under section 741 applied. Consequently, it treated the gain as arising from the sale of a capital asset and sourced to the foreign partner's domicile.

In response to the Tax Court's decision in *Grecian Magnesite*, Congress amended section 864(c) as part of the Tax Cuts and Jobs Act. The updated provision sources gains from the sale of a partnership interest to the United States by applying a look-through approach that considers the partnership's operations and asset composition in prior years.

Several states have adopted similar sourcing methods, which this article examines further in

<sup>1</sup>"Side Letter — Stakes High," *Private Equity International* (Dec. 2, 2025).

<sup>2</sup>*Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner*, 149 T.C. 63 (2017).

the context of nonresident, noncorporate partners in a multistate partnership.

### Two Common State Sourcing Methods

Traditionally, states treat the sale of a partnership interest for nonresident, noncorporate partners as the sale of intangible property and source the resulting gain or loss to the partner's domicile, commonly referred to as the *mobilia sequuntur personam* doctrine. However, some states recognize an exception when a partnership establishes a business situs in another jurisdiction, known as the business situs rule.<sup>3</sup>

Practitioners have long argued over which method is more appropriate. In January 2025 the Multistate Tax Commission released a draft issue outline to provide a comprehensive list of potential issues stemming from state taxation of partnerships.<sup>4</sup> One issue is state taxation of gain (loss) from the sale of partnership interests.

### Mobilia Sequuntur Personam Doctrine

The *mobilia sequuntur personam* doctrine, which translates to “movables or intangibles follow the person” and is also known as the home port doctrine,<sup>5</sup> was enunciated in *Pacific Mail Steam-Ship Co.*<sup>6</sup> In that case, the U.S. Supreme Court decided that a New York-based and -owned transportation vessel company that had New York and San Francisco routes was not subject to California taxation. The Court reasoned that the vessels:

remained in California no longer than was necessary to land their passengers and freight. . . . They were temporarily engaged in lawful trade and commerce with their situs at the home port, where the vessels belonged, and where the owners were liable to be taxed for the capital invested, and where the taxes had been paid.<sup>7</sup>

Perhaps the most quoted U.S. Supreme Court decision establishing the *mobilia sequuntur personam* doctrine is *Lawrence v. State Tax Commission*,<sup>8</sup> in which an individual resident of Mississippi brought suit against the state of Mississippi over the taxability of income generated by his construction business conducted in Tennessee. The Court characterized that as Mississippi trying to impose income tax on income derived wholly from activities carried on outside the state, and stipulated the rationale of the home port doctrine as follows:

The obligation of one domiciled within a state to pay taxes there, arises from unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits. Hence, domicile in itself establishes a basis for taxation. Enjoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government. . . . The Federal Constitution imposes on the states no particular modes of taxation, and apart from the specific grant to the federal government of the exclusive . . . power to levy certain limited classes of taxes and to regulate interstate and foreign commerce, it leaves the states unrestricted in their power to tax those domiciled within them, so long as the tax imposed is upon property within the state or on privileges enjoyed there, and is not so palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment.<sup>9</sup>

Several courts have followed *Hays* and *Lawrence* and developed the state rationale further for corporate taxpayers.<sup>10</sup> In *Chestnut Securities Co.*, the Tenth Circuit had to determine whether

<sup>3</sup>Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, at para. 20.05[6] (Dec. 2025).

<sup>4</sup>Multistate Tax Commission, “State Taxation of Partnerships: Issue Outline” (updated Jan. 1, 2025).

<sup>5</sup>Hellerstein and Hellerstein, *supra* note 3, at para. 9.03[1].

<sup>6</sup>*Hays v. Pacific Mail Steam-Ship Co.*, 58 U.S. 596 (1855).

<sup>7</sup>*Id.*

<sup>8</sup>*Lawrence v. State Tax Commission*, 286 U.S. 276 (1932).

<sup>9</sup>*Id.*

<sup>10</sup>Bruce Fort, “Source-Based Taxation of Intangibles — It’s Not Often Easy, and Not Often Kind, but Necessary,” at fig. 1, Multistate Tax Commission Uniformity Committee meeting (2024).

the taxpayer principally transacted its business where the securities were purchased and sold “and not at the source of the power from which emanates all authority.”<sup>11</sup> The court found that the taxpayer was carrying on or transacting its principal business within the state of Oklahoma because the intangible property was used directly in the transaction of business in the state “so as to become an integral part of the property of the state in which it is employed.”<sup>12</sup>

The court found determinative that the corporate officers established the company’s business policies in Tulsa, Oklahoma, which was the nerve center of all business and transactions, with no transaction consummated unless and until the directors, who resided in Tulsa, first determined that the action be taken.

The Minnesota Supreme Court addressed a similar issue in *Cargill Inc.*<sup>13</sup> The corporate taxpayer’s general business office was in Minneapolis, where the taxpayer conducted all corporate business and managed and controlled its operations, including those in Minnesota and other states. At issue was whether the dividend income from the taxpayer’s out-of-state subsidiaries was subject to Minnesota income tax.

The court decided that the dividend income was subject to taxation in Minnesota, saying that even though the taxpayer’s business extended into other states, for tax purposes, “intangibles have a situs at the taxpayer’s commercial domicile,”<sup>14</sup> which in this case was in Minnesota.

In *VAS Holdings & Investments LLC*,<sup>15</sup> Massachusetts sought to tax the gain realized by VASHI, a nondomiciliary corporation, on the sale of an interest in Cloud5 LLC, a passthrough entity doing business in Massachusetts. VASHI (based outside Massachusetts) merged with Thing5 (a Massachusetts LLC) to form Cloud5. VASHI later sold its Cloud5 interest, realizing a large capital gain.

The commissioner of revenue assessed Massachusetts tax on that gain, arguing it was connected to Cloud5’s growth in Massachusetts and that VASHI benefited from protections and opportunities provided by the state. VASHI’s position was that only the unitary business principle allows Massachusetts to tax such gain. That principle requires functional integration, centralized management, and economies of scale between the taxpayer and the in-state entity or that the investment serves an operational function. VASHI argued that no such unitary relationship existed.

The Massachusetts Supreme Judicial Court conducted a thorough constitutional analysis and agreed with the commissioner that “the protections, opportunities, and benefits provided by the commonwealth to Cloud5 suffice to meet the constitutional requirement of a nexus between the Commonwealth and VASHI; and, because the tax imposed by the commonwealth reflects the apportionment formula of Cloud5, the tax is circumscribed to capture the value of those protections and benefits.”<sup>16</sup>

The court further found that Cloud5 flourished in Massachusetts and that “nexus satisfies the Due Process and Dormant Commerce Clauses, permitting the Commonwealth to extend its taxing authority to the fiscal measure of Cloud5’s growth.”<sup>17</sup>

However, the court ruled that the commissioner created an investee apportionment rule, which was the legislature’s responsibility, and in doing so, exceeded its authority. Accordingly, the court said the commissioner could not tax VASHI’s capital gain from the sale of its Cloud5 interest because there was no statutory authority, even though the constitutional requirements were met.

Conversely, in *Goldman Sachs Petershill Offshore Holdings (Delaware) Corp.*,<sup>18</sup> a New York appellate court held that the capital gain arising from a taxpayer’s sale of its minority membership interest in an LLC that conducted activities in

<sup>11</sup> *Chestnut Securities Co. v. Oklahoma Tax Commission*, 125 F.2d 571, 575-576 (10th Cir.) (alternative holding), cert. denied, 316 U.S. 668 (1942).

<sup>12</sup> *Id.*

<sup>13</sup> *Cargill Inc. v. Spaeth*, 10 N.W.2d 728 (Minn. 1943).

<sup>14</sup> *Id.*

<sup>15</sup> *VAS Holdings & Investments LLC v. Commissioner*, 186 N.E.3d 1240 (Mass. 2022).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Goldman Sachs Petershill Offshore Holdings (Delaware) Corp. v. New York City Tax Appeals Tribunal*, N.Y. Slip Op. 2361 (N.Y. App. Div. Apr. 12, 2022).

New York City was subject to the general corporation tax even though the taxpayer had no other presence in the city.

The court cited *Allied-Signal Inc.*, saying “it did not matter whether the taxpayer was present or domiciled in the City because the business activities conducted in the City by the entity in which the taxpayer had invested provided a nexus between the taxpayer’s capital gain and the City, even in the absence of a unitary relationship between the corporations.”<sup>19</sup>

Finally, the court found that the taxpayer’s activities in the city were sufficient to establish nexus between the taxpayer’s capital gain and the city.

In summary, when applying the *mobilia sequuntur personam* doctrine, states might first look to where the taxpayer exercises its decision-making process, and if the first factor is not determinable, then to the taxpayer’s legal domicile (for noncorporate taxpayers) or commercial domicile (for corporate taxpayers).

### Business Situs Doctrine

The seminal Supreme Court case on the business situs doctrine for intangible property is *New York ex rel. Whitney v. Graves*, in which the Court said:

When we speak of a “business situs” of intangible property in the taxing State we are indulging in a metaphor. We express the idea of localization by virtue of the attributes of the intangible right in relation to the conduct of affairs at a particular place. The right may grow out of the actual transactions of a localized business or the right may be identified with a particular place because the exercise of the right is fixed exclusively or dominantly at that place. In the latter case the localization for the purpose of transacting business may constitute a business situs quite as clearly as the conduct of the business itself. . . . An intangible property right may have a “business situs” in a State for tax purposes either because the right grows out of the

actual transactions of a business there localized, or because its exercise is fixed there, exclusively or dominantly.<sup>20</sup>

In *Whitney*, the taxpayer was a nonresident of New York who owned a seat on the New York Stock Exchange and could thus personally buy and sell securities in the market. Even though he had no office or abode in New York, he could fill all his customers’ orders by sending the orders to New York for execution on the exchange floor by fellow members. The Supreme Court said:

We think that the dominant attribute of relator’s membership in the New York Stock Exchange links it to the situs of the Exchange as to localize it at that place and hence to bring it within the taxing power of New York. Accordingly, we hold that in laying the tax upon the profits derived by the relator from the sale of the right appurtenant to his membership the State did not exceed the bounds of its jurisdiction.<sup>21</sup>

Two other notable cases illustrating the business situs doctrine come from the U.S. Supreme Court and the Ohio Supreme Court.

In *Curry v. McCanless*,<sup>22</sup> the U.S. Supreme Court explained that when an owner of intangibles limits activities to its domicile, it is convenient to apply the rule that such intangibles are taxed at their situs — often expressed through the maxim *mobilia sequuntur personam*, meaning the association of intangibles with the owner at its domicile provides jurisdiction to tax.

However, the Court clarified that when a taxpayer extends intangible-related activities beyond its home state and benefits from that other state’s laws and protections, the rationale for a single place of taxation no longer applies. In those cases, the rule becomes inadequate to address each state’s constitutional power. The Court concluded that a taxpayer domiciled in one state but conducting business in another might be subject to tax in that other state,

<sup>19</sup> *Allied-Signal Inc. v. Commissioner*, 588 N.E.2d 731 (N.Y. 1991).

<sup>20</sup> *New York ex rel. Whitney v. Graves*, 299 U.S. 366, 372-373 (1937).

<sup>21</sup> *Id.*

<sup>22</sup> *Curry v. McCanless*, 307 U.S. 357 (1939).

measured by the value of intangibles used in the business.

In two cases following *Curry*,<sup>23</sup> the U.S. Supreme Court upheld taxes on dividends paid to nonresident owners even though those owners had no physical presence in the taxing state.

In *Corrigan v. Testa*,<sup>24</sup> the taxpayer acquired a majority interest in an LLC that operated throughout the United States. Even though the taxpayer served as the managing member of the LLC and oversaw its operations, the Ohio Supreme Court found that he was neither active in the business nor engaged in any related unitary activities. Although there was no doubt that the majority partner's partnership income apportioned to Ohio on a passthrough basis was taxable, the court held that gain from the sale of the interest was different. It characterized the gain as investment income, determined that Ohio lacked nexus over the transaction, and concluded that the traditional method of sourcing such gains from the sale of personal intangible property to the owner's domicile was the appropriate method. However, the court also emphasized the need to use the investee's apportionment factors to source the gain.

Shortly after *Corrigan*, the Ohio Supreme Court changed its position, saying in *T. Ryan Legg Irrevocable Trust v. Testa*<sup>25</sup> that *Corrigan* was wrongly decided. The concurring opinion stated that *Corrigan* erred in concluding that the default situs for investment income was the taxpayer's domicile and that it would instead have determined that applying the type of apportionment provided under Ohio law was permissible.

## Business Income Under the Unitary Business Principle

Several state supreme courts have held that a state can tax the gain from the sale of a majority interest in a partnership by nonresident individual owners when the income is considered business income of a unitary business and the business has a sufficient connection to the state.<sup>26</sup>

However, uncertainty remains regarding the appropriate test for determining unity when a holding company holds an interest in the passthrough entity.

## Conclusion

Federal rules, the U.S. Supreme Court, and state courts suggest that the most common method for sourcing the gains or losses from the sale of a partnership interest for nonresident individuals is the partner's domicile — the *mobilia sequuntur personam* doctrine. However, there might be an exception to that common principle (for example, the apportionment method) if the gains (losses) are considered business income of a unitary business and the business has a sufficient connection to the state.

Also, significant uncertainty remains in states that have not adopted an apportionment approach. That lack of uniformity creates challenges, particularly for multistate partnerships with complex, multitier structures. Clearer and more consistent state guidance is needed to reduce confusion and enable equitable tax administration across jurisdictions.

Taxpayers, especially general partners in a partnership, should consult with their tax advisers whenever they sell partnership interests to nonresident individuals as their ultimate owners to determine the state sourcing method for the resulting gains or losses. ■

<sup>23</sup> *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940); *International Harvester Co. v. Wisconsin Department of Revenue*, 322 U.S. 435 (1944).

<sup>24</sup> *Corrigan v. Testa*, 73 N.E.3d 381 (Ohio 2016).

<sup>25</sup> *T. Ryan Legg Irrevocable Trust v. Testa*, 75 N.E.3d 184 (Ohio 2016).

<sup>26</sup> *Noell Industries Inc. v. Idaho Tax Commission*, 470 P.3d 1176 (Idaho 2020), *cert. denied*, 141 S. Ct. 1391 (2021); *Blue Bell Creameries LP v. Roberts*, 333 S.W.3d 59 (Tenn. 2011), *cert. denied*, 131 S. Ct. 3068 (2011); and *YAM Special Holdings Inc. v. Commissioner of Revenue*, 947 N.W.2d 438 (Minn. 2020).