

**The Plain Language of Texas Constitution Article 8, Section 24(a)
Is Applicable to Income Tax Impositions on Partnership Entities.**

When viewed in light of the plain language of Texas Constitution article 8, section 24(a) and relevant authorities, the imposition of the Margin Tax would bring the constitutional provision into play, thereby requiring a public referendum to validate imposition of the tax.

Texas Constitution article 8, section 24(a) provides:

A general law enacted by the legislature that imposes a tax on the net incomes of natural persons, including a person's share of partnership and unincorporated association income, must provide that the portion of the law imposing the tax not take effect until approved by a majority of the registered voters voting in a statewide referendum held on the question of imposing the tax. The referendum must specify the rate that will apply to taxable income as defined by law.

Hereinafter, the constitutional provision will be referred to as the "Bullock Amendment."

The Bullock Amendment Is Applicable to Partnership Level Taxation.

As the 75th and 79th legislatures confirmed (see discussion below), the Bullock Amendment's language makes clear that its coverage includes an income tax on a partnership interest attributable to a natural person, whether imposed at the partnership or individual level. Moreover, the Bullock Amendment specifically refers to "a person's share of partnership and unincorporated association income." This plain language makes no distinction between general partnerships, limited partnerships and limited liability partnerships, and applies even if the partnership is viewed as a separate legal entity.

Notwithstanding this plain language, Margin Tax proponents assert that the provision is not applicable, because: (i) a partnership can be taxed at the entity level **before** the individual partner's share of partnership income is calculated or distributed; and (ii) such tax is outside the scope of the Bullock Amendment, which is limited to taxes imposed directly on the individual partner.

This assertion is wrong, because it ignores the Bullock Amendment's plain language, which has two separate and distinct prongs:

First Prong	“a tax on the net incomes of natural persons”	Applies at the very least to a tax imposed on individual partners after the partnership 's federal taxable income is calculated and allocated to the partners; also applies to partnership entity level taxation, which has the identical economic impact.
Second Prong	“a person's share of partnership and unincorporated association income”	Confirms application to a tax imposed at the partnership entity level before the individual partner's share of partnership income is calculated or distributed.

A reading of both prongs of the Bullock Amendment makes clear that its coverage includes an income tax imposed at either the partnership entity level or the individual partner level. The first prong clearly covers taxation at the individual partner level after partnership income is calculated. Therefore, the assertion made by Margin Tax proponents – a partnership can be taxed at the entity level **before** the individual partner's share of partnership income is calculated or distributed – makes a nullity of the second prong. As the first prong precludes any form of tax imposed directly on the partner, the second prong must apply to a tax imposed at the partnership entity level – otherwise, it would have no meaning.

In construing constitutional or statutory provisions, every word is presumed to have been used for a purpose, and a cardinal rule of statutory construction requires that each sentence, clause, phrase and word be given effect if reasonably possible. *Eddins-Walcher Butane Co. v. Calvert*, 298 S.W.2d 93, 96 (Tex. 1957); *see also Cameron v. Terrell & Garrett, Inc.*, 618 S.W.2d 535, 540 (Tex. 1981). In this case, the proper interpretation of the Bullock Amendment

must take into account all of its language, including the second prong, which confirms inclusion of a partnership level tax in the constitutional coverage. Any other interpretation would nullify the Bullock Amendment's language in contravention of the cases cited above.

By Virtue of Its Practical Effect, a Partnership Level Tax Is Within the Bullock Amendment's Scope.

The Courts View Taxes in a Manner Consistent with Their Economic Substance and Practical Effect.

The imposition of an income tax on a partnership interest at the partnership level is no different in economic substance or practical effect than the assessment of the same tax against the individual owner of such partnership interest. In this context, the courts will view the tax in a manner consistent with its practical operation. In *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911), the Court stated:

[T]he mere declaration contained in the statute that it shall be regarded as a tax of a particular character does not make it such if it is apparent that it cannot be so designated consistently with the meaning and effect of the act

220 U.S. at 145.

The Texas Courts Similarly View Tax Impositions Consistently with Their Economic Substance and Practical Effect.

In *Suburban Utility Corporation v. Public Utility Commission of Texas*, 652 S.W.2d 358 (Tex. 1983) the question concerned the determination of Suburban's cost of service for rate making purposes. Pursuant to the applicable statute, taxes were to be included in the cost of service. However, the Public Utility Commission ("PUC") disallowed the inclusion of federal income tax expense in Suburban's cost of service. The PUC's disallowance was based on the fact that Suburban was a "Subchapter S" corporation for federal tax purposes; accordingly, the

federal income taxes attributable to its operations were not paid at the corporate level, but instead were paid by the corporation's shareholders.

Reversing the PUC's disallowance, the Texas Supreme Court concluded that even though applicable federal income taxes were paid at the shareholder level rather than the corporate level, Suburban was entitled to a reasonable cost of service allowance for such taxes. The Court reasoned:

The income taxes required to be paid by shareholders of a Subchapter S corporation on a utility's income are inescapable business outlays and are directly comparable with similar corporate taxes which would have been imposed if the utility operations had been carried on by a corporation. Their elimination from cost of service is no less capricious than the excising of salaries paid to a utility's employees would be. We therefore hold that Suburban is entitled to a reasonable cost of service allowance for federal income taxes actually paid by its shareholders on Suburban's taxable income or for taxes it would be required to pay as a conventional corporation, whichever is less.

652 S.W.2d at 364.

The identical reasoning is applicable to an analysis of the Bullock Amendment: the imposition of an income tax at the partnership entity level is no different in economic substance than the assessment of the same tax against the individual owner of such partnership interest. The entity-level tax imposed on the partnership is in practical effect "a tax on the net incomes of natural persons" within the meaning of the Bullock Amendment's first prong. Of course, such tax imposition also is within the coverage of the Bullock Amendment's second prong.²

In *Gragg v. Cayuga Independent School District*, 539 S.W.2d 861 (Tex. 1976), the Texas Supreme Court interpreted Texas Constitution article 8, section 1-d, which provides special agricultural use valuation for lands owned by natural persons where agriculture is the natural person's primary occupation and source of income. The taxpayer held oil and gas investments in

² *Suburban Utility Corporation* involved a corporation, which clearly was a separate entity that provided liability limitations for its owners. Therefore, the decision makes clear that the analysis is based on the economic substance of the tax imposition, not on entity classification or liability limitation attributes.

partnership form, the net income from which was introduced into evidence and taken into account by the Court in making the determination of primary source of income. While the issue in the case was whether the net or gross income from the partnerships should have been utilized, the Court clearly treated the partnership income as attributable to the partner. Therefore, in the context of another Texas constitutional provision relating to "natural persons," the Court viewed the net income of the partnership as that of the partner.³

The Same Reasoning Applies to Tax Impositions on Professional Services Partnerships.

In *Bishop v. District of Columbia*, 401 A.2d 955 (D.C. 1979), the court construed the District of Columbia tax on unincorporated businesses as applied to a professional services partnership.⁴ The District of Columbia Home Rule Act prohibited a tax on the personal income of non-residents. D.C. CODE ANN. § 1-206.02(a)(5). The imposition of the tax at the partnership level was challenged by partners in District of Columbia law firms who were residents of surrounding states. The basis for the challenge was that the District of Columbia unincorporated business tax was actually a prohibited tax on the personal incomes of non-residents.

The District of Columbia made the same argument that is being made by the Margin Tax proponents here: the tax was not a personal income tax, because it was titled an unincorporated business tax and was imposed at the business entity level. Rejecting this contention, the District of Columbia Court of Appeals held that "as to the characterization of the tax, it is fundamental that the nature and effect of the tax, not its label, determine if it is an income tax or not." *Bishop*,

³ The Court indicated that it similarly would have used the partnership's gross income as that of the partner had it been introduced into evidence.

⁴ The District of Columbia Code presently contains an exception for a "trade or business in which more than eighty percent of the gross income is derived from the personal services actually rendered by the individuals or the members of the partnership. . . and in which capital is not a material income-producing factor." D.C. CODE ANN. § 47-1808.01(3). Therefore, service partnerships presently are exempt from the tax.

401 A.2d at 958. The court concluded that “since the tax is on unincorporated business, [it] is therefore in reality a tax on the associates or partners who run the business.” *Id.* at 961.

The *Bishop* decision establishes that the proposed Margin Tax is within the Bullock Amendment’s scope. Significantly, the District of Columbia statute prohibiting a tax on the personal income of non-residents was written narrowly, containing language equivalent only to the first prong of the Bullock Amendment. Thus, the Bullock Amendment’s second prong, which pertains specifically to taxes imposed at the entity level, confirms this result.

Other Judicial Precedents Support the Principle that the Formal Label Given to a Tax Does Not Control Its Validity.

The courts consistently have invalidated taxes that have the effect of taxing certain types of income prohibited from taxation, regardless of whether such taxes are labeled as income taxes or are directly imposed on such “untaxable” income.

- *Northwestern Mutual Life Insurance Co. v. Wisconsin*, 275 U.S. 136 (1927). The Wisconsin taxing authorities argued that a “license fee” imposed on the gross income of insurance companies was a privilege or franchise tax rather than a tax on property or income. The taxpayer argued that income from tax-exempt United States bonds was effectively subjected to the tax. The Court held that the license fee was impermissible inasmuch as it resulted in a tax on the income of the taxpayer’s exempt bonds.
- *Galveston, Harrisburg, & San Antonio Railway v. Texas*, 210 U.S. 217 (1908). The Supreme Court considered the constitutionality of a Texas statute imposing a tax “equal to” 1% of the gross receipts of certain railroad corporations. A portion of the taxpayer’s gross receipts was derived from transporting passengers and cargo outside of Texas. The Court held that regardless of the tax’s label as a tax “equal to a percentage” of gross receipts, it was an unconstitutional attempt to tax receipts earned in interstate commerce, stating that “[n]either the state courts nor the legislatures, by giving the tax a particular name or by the use of some form of words, can take away our duty to consider its nature and effect.” *Id.* at 227.
- *Continental Bank v. Arizona Department of Revenue*, 638 P.2d 228 (Ariz. Ct. App. 1981). An Arizona statute that required a reduction of net operating losses by an amount equal to interest from United States bonds and municipal bonds was held to violate the Arizona Constitution, which exempted income from state, municipal and city bonds from tax. The court concluded that the effect of that

statute was to unconstitutionally increase the income tax burden of a holder of tax-exempt securities.

In summary, the case law establishes that “wishin’ don’t make it so.”

Florida's Interpretation of a Similar Constitutional Provision Suggests that the Proposed MT Cannot Validly Apply to Partnerships Owned by Natural Persons.

The Florida Legislature’s statutory interpretation of a constitutional provision similar to the Bullock Amendment further confirms the proposed Margin Tax’s invalidity as applied to partnerships without voter approval. Florida Constitution article VII, section 5 provides:

Natural persons. No tax upon estates or inheritances or upon the income of natural persons who are residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.

The Florida statutes, like Texas, treat partnerships as entities distinct from the partners for most purposes. FLORIDA STAT. ANN. § 620.8201. Nevertheless, the Florida Legislature construed the constitutional limitation as being applicable to partnership income. Florida Statutes Annotated Section 220.02 provides in pertinent part:

This code is not intended to tax, and shall not be construed so as to tax, any natural person who engages in a trade, business, or profession in this state under his or her own or any fictitious name, whether individually as a proprietorship or in partnership with others, or as a member or manager of a limited liability company classified as a partnership for federal income tax purposes;

This statement of intent shall be given preeminent consideration in any construction or interpretation of this code in order to avoid any conflict between this code and the mandate in § 5, Article VII of the State Constitution that no income tax be levied upon natural persons who are residents and citizens of this state.⁵

The Florida constitutional prohibition on personal income taxes, like the District of Columbia statute discussed above, contained a prohibition similar to only the first prong of the Bullock Amendment. Neither the Florida nor District of Columbia prohibitions contained

⁵ Florida Annotated Statutes Section 220.02 is reproduced in full at Appendix B to this brief.

language similar to the Bullock Amendment's second prong that is specifically applicable to a person's share of partnership or unincorporated association income.

Notwithstanding the narrow nature of the Florida and District of Columbia prohibitions, the Florida Legislature and the District of Columbia Court of Appeals both construed the limited scope constitutional provisions to prohibit the type of tax imposition now being proposed in Texas. These authorities establish that the proposed Texas Margin Tax cannot validly be assessed against partnership entities in the absence of voter approval. Such imposition clearly is within the scope of the broader prohibitions set forth in the Bullock Amendment.

The Proposed Margin Tax's Invalidity as Applied to Partnerships Previously Was Confirmed by the Texas Legislature.

Prior to the passage in the 2005 Regular Session of House Bill 3, 79th Legislature, Regular Session (2005) ("H.B. 3"), the only major franchise tax reform bill that passed either the Texas House or Senate subsequent to adoption of the Bullock Amendment was House Bill 4, 75th Legislature, Regular Session (1997) ("H.B. 4"). As originally filed, H.B. 4 proposed a value-added tax similar to the proposed Margin Tax in that the tax base was broader than the entity's net income for federal tax purposes. H.B. 4 was amended in the House Committee, and the versions of the bill that passed the House and Senate extended the existing franchise tax to partnerships and other unincorporated entities except for proprietorships. Both the House and Senate versions would have imposed the franchise tax at the entity level.⁶

H.B. 4, as initially passed by the House and Senate, specifically provided that it would become effective only if the voters approved House Joint Resolution 4, 75th Legislature, Regular

⁶ The H.B. 4 franchise tax provisions were deleted in conference committee, and the bill as finally passed did not expand the business tax base.

Session (1997) (“H.J.R. 4”). See H.B. 4 § 7.01 (Introduced Version); H.B. 4 § 25.01(a) (House Engrossed Version); H.B. 4 § 15.01(a) (Senate Version). H.J.R. 4, as passed by the House and Senate, would have limited the scope of the Bullock Amendment by adding a new article 8, section 24(k) to the Texas Constitution to read as follows:

This section does not apply to a privilege or franchise tax measured by the income of a corporation, partnership, or other business entity, other than a sole proprietorship.

H.J.R. 4 § 6 (House Engrossed Version); H.J.R. 4 § 6 (Senate Version).

H.J.R. 4 would have revised the Bullock Amendment to effectively eliminate its second prong relating to “a person’s share of partnership and unincorporated association income.” The reason for H.J.R. 4 is clear: The imposition by H.B. 4 of an entity-level tax on partnerships and other unincorporated entities would not have been valid under the Bullock Amendment unless approved by the voters. Therefore, H.J.R. 4 was passed by the House and Senate in 1997 as an enabling constitutional amendment to H.B. 4. The precedential impact of these actions is clear by virtue of the fact that the Bullock amendment had been approved just four years earlier, and Lieutenant Governor Bullock, the source of the Amendment, still served as Lieutenant Governor.

In this setting, the Legislature’s actions in 1997 confirm the Bullock Amendment’s original intention: to prohibit the imposition on partnerships or other unincorporated businesses of an entity-level tax measured by net income, unless approved by the voters.

H.B. 3 as Passed by the House During the 2005 Regular Session Recognized the Scope of the Bullock Amendment.

H.B. 3, as passed by the House during the 2005 Regular Session, would have enacted the Reformed Franchise Tax, which would have allowed business entities to elect either an employer compensation-based tax or the existing franchise tax. In the event an unincorporated entity

owned wholly or partially by natural persons elects to be subject to the franchise tax, H.B. 3 required that the business and those natural persons agree pursuant to the election form that the taxable earned surplus of the business shall be calculated without regard to any exclusion, exemption or prohibition set forth in the Bullock Amendment.⁷

Pursuant to Texas law, constitutional rights may be waived by act or omission, both in a civil and criminal context. *Fort Worth Indep. School Dist. v. City of Fort Worth*, 22 S.W.3d 831 (Tex. 2000); *Garrett v. State*, 998 S.W.2d 307, 317 (Tex. App. – Texarkana 1999, petition for discretionary review refused); *Yandell v. Tarrant State Bank*, 538 S.W.2d 684, 687 (Tex. Civ. App. – Fort Worth 1976, writ ref'd n.r.e.); *Young v. City of Colorado*, 174 S.W. 986, 994 (Tex. Civ. App. – Fort Worth 1915, writ ref'd). In addition, the Texas courts will not pass on the constitutionality of a statute at the instance of one who has availed himself of its benefits. *Fort Worth Indep. School Dist. v. City of Fort Worth*, 22 S.W.3d 831, 844 (Tex. 2000). This rule also has been followed in the context of tax statutes. *Hurst v. Guadalupe County Appraisal Dist.*, 752 S.W.2d 231, 233 (Tex. App. – San Antonio 1988, no writ).

This provision recognized the applicability of the Bullock Amendment to any form of income tax imposed on an unincorporated entity in which an interest is owned by a natural person. It also set forth a realistic solution to partnership taxation: the use of a taxpayer election coupled with a waiver provision.

The Margin Tax is an Income Tax Subject to the Bullock Amendment.

Proponents of the Margin Tax assert that the Bullock Amendment is inapplicable, because the proposed tax is based on gross revenues less compensation paid (limited to \$300,000

⁷ See H.B. 3, Section 2.05, which would have added new Texas Tax Code section 171.0012(c).

per person) and benefits paid, with the tax base then apportioned to Texas. The proponents take the position that this is not an income tax, because the tax base is larger than net income as computed for federal tax purposes. These assertions are erroneous.

The Bullock Amendment Applies to Partnership “Income”, Not “Net Income”.

The Bullock Amendment defines its scope to include:

A general law enacted by the legislature that imposes a tax on the **net incomes** of natural persons, including a person’s share of partnership and unincorporated association **income**.... (emphasis added)

This language makes clear that as applied to partnerships and unincorporated associations, the Bullock Amendment covers taxes on income, not “net income”. This terminology encompasses various definitions. In *Humble Oil & Refining Co. v. Calvert*, 478 S.W.2d 926 (Tex. 1972), the Court noted that “taxes on income” or “income taxes” describe a generic class of taxes with variously described bases or measures of income:

A particular ‘income tax’ may, of course, define its base more narrowly and selectively than the broadest definition of income. A particular income tax may select different points in time at which the income will be recognized, such as the time of sale, time of receipt, time of manufacture or production, et cetera. Whatever these differences, however, the tax does not cease to be an income tax.

The greatest body of authority with respect to income taxes is to be found in the statutes, regulations, cases and other authorities relating to the United States federal income tax, Internal Revenue Code of 1954, Title 26, United States Code. **For purposes of the federal income tax, the Supreme Court of the United States has rejected the effort to develop a single comprehensive definition of income, stating that ‘no single, conclusive criterion has yet been found to determine in all situations what is sufficient gain to support the imposition of an income tax.’** *Commissioner of Internal Revenue v. Wilcox*, 327 U.S. 404, 407, 66 S.Ct. 546, 549, 90 L.Ed. 752 (1946).

478 S.W.2d 929 (emphasis added).

The absence of a single comprehensive definition of income for federal tax purposes is made clear by a review of Internal Revenue Service Form 1065, U.S. Return of Partnership Income, a copy of which is attached as Appendix C. Trade or business income and expenses are listed on page 1, lines 2 through 21, with “**Ordinary business income (loss)**” listed at line 22. The ordinary business income (loss) figure then is placed on Schedule K (page 3), line 1. This figure in turn is reported on the individual partner’s personal federal income tax return.

Significantly, the ordinary business income (loss) figure does not represent all income and expense items relating to the partnership. For example, net rental real estate income, dividend and interest income, royalties and long-term and short-term capital gains and losses are not a part of the ordinary business income (loss) figure. Rather, these items are listed separately on Schedule K, lines 2 through 11, and then reported in separate sections of the partner’s personal tax return. Similarly, various deductions, credits and related recaptures, etc. are reported elsewhere on Schedule K and then reported in separate sections of the partner’s personal income tax return.

There are additional complexities. For example, certain deductible expenses related to the partnership may be incurred directly by the partner and reported directly on the partner’s individual income tax return (without being listed on the partnership return). Examples include debt incurred by the partner to purchase his partnership interest, professional association dues and licensing fees directly paid by the partner and depreciation on furniture, computers, etc. owned and used by the partner in connection with the partnership’s trade or business.

This federal tax reporting mechanism for partnerships demonstrates that there is no single “income” or “net income” figure for partnerships. Rather, the ordinary business income (loss) figure at page 1, line 22, is the product of certain, but not all, income and expense items of the

partnership. Numerous other items are reflected separately on Schedule K and then reported on specified schedules and lines of the individual partner's personal income tax return. The absence of a single "income" or "net income" figure relating to a partnership makes clear that the Bullock Amendment did not intend a single definition of "income" or "net income". This is because such definition simply does not exist, and therefore a "single comprehensive definition" would be unworkable.

Alternatively, the Bullock Amendment Applies to the Margin Tax, Even if its Scope is "Net Income".

Alternatively, the Bullock Amendment applies to the Margin Tax even if (i) the "net income" definition is deemed applicable; and (ii) the measure of the Margin Tax is broader than "net income", however defined. This follows from the plain language of the Bullock Amendment:

A general law enacted by the legislature that imposes a tax on the net incomes of natural persons . . . "

This language does not base the applicability of the Bullock Amendment on the **classification** of the tax imposed. Rather, the criteria is the **economic object** of the tax – that is, net income⁸. If the Margin Tax base exceeds "net income", however defined, the net income component must be carved out as immune from taxation, while the remaining base would be taxable without regard to the Bullock Amendment. Therefore, in a hypothetical situation where the partnership "net income" is defined to be \$400,000 and the Margin Tax base is \$500,000, the

⁸ The language of the Bullock Amendment relying on the economic object of taxation must be distinguished from statutory provisions containing a classification of the tax system. For example, Public Law 86-272, 15 U.S.C.A. § 381, prohibits states from imposing a net income tax on income derived in the state from interstate commerce if the only business of the taxpayer in the state is the mere solicitation of sales and if any orders are filled by shipments from outside the state. The operational statutory language provides: "no State . . . shall have the power to impose a net income tax on the income derived within such State . . . 15 U.S.C.A. § 381 (a). (emphasis is added). This language keys on the classification of the tax system, not the economic object of taxation. See *Gillette Company v. Michigan Department of Treasury*, 497 N.W.2d 595 (Mich. Ct. of Appeals 1993).

Bullock Amendment at the very least immunizes from taxation the \$400,000 net income component.

Conclusion

The plain language of the Bullock Amendment is susceptible to only one meaning: the imposition of the Margin Tax on a partnership entity would be prohibited, unless approved by the voters. This interpretation also is mandated by decisions of the United States and Texas Supreme Courts and other states' appellate courts. The Florida Legislature's statutory construction of that state's constitutional provision regarding personal income taxation also supports this construction of the Bullock Amendment. Finally, in 1997 – just four years after the Bullock Amendment's adoption – the Texas House and Senate understood that its coverage included entity-level partnership taxation. The Bullock Amendment's coverage is the same today.

BAKER BOTTS L.L.P.

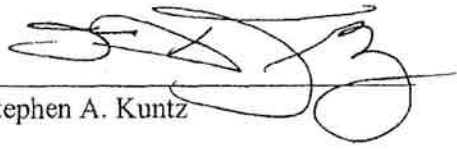
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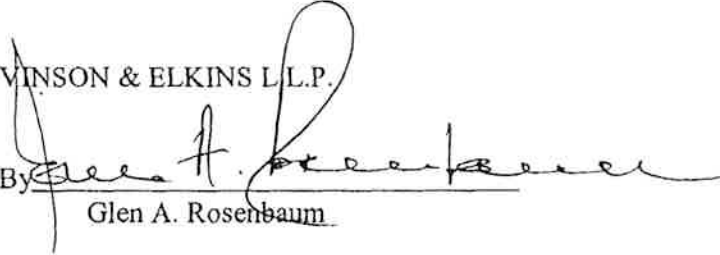
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APPENDIX A

Law Firm Legislative Coalition Member Firms

Akin, Gump, Strauss, Hauer & Feld, L.L.P.
Allen Boone Humphries Robinson LLP
Andrews & Kurth L.L.P.
Baker Botts L.L.P.
Bracewell & Giuliani, L.L.P.
Cantey & Hanger L.L.P.
Carrington, Coleman, Sloman & Blumenthal, L.L.P.
Doyle, Restrepo, Harvin & Robbins, L.L.P.
Fulbright & Jaworski L.L.P.
Gardere Wynne Sewell LLP
Hunton & Williams LLP
Jackson Walker L.L.P.
Jones Day
Meadows, Owens, Collier, Reed, Cousins & Blau, L.L.P.
Strasburger & Price, LLP
Thompson & Knight LLP
Vinson & Elkins L.L.P.
Weil, Gotshall & Manges L.L.P.

APPENDIX B

Florida Statutes Annotated § 220.02:

It is the intent of the Legislature in enacting this code to impose a tax upon all corporations, organizations, associations, and other artificial entities which derive from this state or from any other jurisdiction permanent and inherent attributes not inherent in or available to natural persons, such as perpetual life, transferable ownership represented by shares or certificates, and limited liability for all owners. It is intended that any limited liability company that is classified as a partnership for federal income tax purposes and formed under chapter 608 or qualified to do business in this state as a foreign limited liability company not be subject to the tax imposed by this code. It is the intent of the Legislature to subject such corporations and other entities to taxation hereunder for the privilege of conducting business, deriving income, or existing within this state. This code is not intended to tax, and shall not be construed so as to tax, any natural person who engages in a trade, business, or profession in this state under his or her own or any fictitious name, whether individually as a proprietorship or in partnership with others, or as a member or manager of a limited liability company classified as a partnership for federal income tax purposes; any estate of a decedent or incompetent; or any testamentary trust. However, a corporation or other taxable entity which is or which becomes partners with one or more natural persons shall not, merely by reason of being a partner, exclude from its net income subject to tax its respective share of partnership net income. This statement of intent shall be given preeminent consideration in any construction or interpretation of this code in order to avoid any conflict between this code and the mandate in § 5, Article VII of the State Constitution that no income tax be levied upon natural persons who are residents and citizens of this state.

APPENDIX C

Form 1065
Department of the Treasury
Internal Revenue Service

U.S. Return of Partnership Income

OMB No. 1545-0099

For calendar year 2005, or tax year beginning, 2005, ending, 20.....
▶ See separate instructions.

2005

A Principal business activity	Use the IRS label. Otherwise, print or type.	Name of partnership	D Employer identification number
B Principal product or service		Number, street, and room or suite no. If a P.O. box, see the instructions.	E Date business started
C Business code number		City or town, state, and ZIP code	F Total assets (see the instructions) \$

- G** Check applicable boxes: (1) Initial return (2) Final return (3) Name change (4) Address change (5) Amended return
H Check accounting method: (1) Cash (2) Accrual (3) Other (specify) ▶
I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ▶

Caution. Include only trade or business income and expenses on lines 1a through 22 below. See the instructions for more information.

Income	1a Gross receipts or sales	1a			
	b Less returns and allowances	1b		1c	
	2 Cost of goods sold (Schedule A, line 8)			2	
	3 Gross profit. Subtract line 2 from line 1c			3	
	4 Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)			4	
	5 Net farm profit (loss) (attach Schedule F (Form 1040))			5	
	6 Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)			6	
	7 Other income (loss) (attach statement)			7	
	8 Total income (loss). Combine lines 3 through 7			8	
Deductions (see the instructions for limitations)	9 Salaries and wages (other than to partners) (less employment credits)			9	
	10 Guaranteed payments to partners			10	
	11 Repairs and maintenance			11	
	12 Bad debts			12	
	13 Rent			13	
	14 Taxes and licenses			14	
	15 Interest			15	
	16a Depreciation (if required, attach Form 4562)	16a			
	b Less depreciation reported on Schedule A and elsewhere on return	16b		16c	
	17 Depletion (Do not deduct oil and gas depletion.)			17	
	18 Retirement plans, etc.			18	
19 Employee benefit programs			19		
20 Other deductions (attach statement)			20		
21 Total deductions. Add the amounts shown in the far right column for lines 9 through 20			21		
22 Ordinary business income (loss). Subtract line 21 from line 8			22		

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than general partner or limited liability company member) is based on all information of which preparer has any knowledge.

▶ Signature of general partner or limited liability company member manager ▶ Date

May the IRS discuss this return with the preparer shown below (see instructions)? Yes No

Paid Preparer's Use Only

Preparer's signature: _____ Date: _____ Check if self-employed Preparer's SSN or PTIN: _____

Firm's name (or yours if self-employed), address, and ZIP code: _____ EIN: _____ Phone no. () _____

Schedule A Cost of Goods Sold (see the instructions)

1	Inventory at beginning of year.	1		
2	Purchases less cost of items withdrawn for personal use	2		
3	Cost of labor	3		
4	Additional section 263A costs (attach statement)	4		
5	Other costs (attach statement).	5		
6	Total. Add lines 1 through 5	6		
7	Inventory at end of year	7		
8	Cost of goods sold. Subtract line 7 from line 6. Enter here and on page 1, line 2	8		

- 9a Check all methods used for valuing closing inventory:
- (i) Cost as described in Regulations section 1.471-3
 - (ii) Lower of cost or market as described in Regulations section 1.471-4
 - (iii) Other (specify method used and attach explanation) ▶
- b Check this box if there was a writedown of "subnormal" goods as described in Regulations section 1.471-2(c) . . . ▶
- c Check this box if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970). . . ▶
- d Do the rules of section 263A (for property produced or acquired for resale) apply to the partnership? . . . Yes No
- e Was there any change in determining quantities, cost, or valuations between opening and closing inventory? Yes No
If "Yes," attach explanation.

Schedule B Other Information

	Yes	No
1 What type of entity is filing this return? Check the applicable box:		
a <input type="checkbox"/> Domestic general partnership		
b <input type="checkbox"/> Domestic limited partnership		
c <input type="checkbox"/> Domestic limited liability company		
d <input type="checkbox"/> Domestic limited liability partnership		
e <input type="checkbox"/> Foreign partnership		
f <input type="checkbox"/> Other ▶		
2 Are any partners in this partnership also partnerships?		
3 During the partnership's tax year, did the partnership own any interest in another partnership or in any foreign entity that was disregarded as an entity separate from its owner under Regulations sections 301.7701-2 and 301.7701-3? If yes, see instructions for required attachment		
4 Did the partnership file Form 8893, Election of Partnership Level Tax Treatment, or an election statement under section 6231(a)(1)(B)(ii) for partnership-level tax treatment, that is in effect for this tax year? See Form 8893 for more details		
5 Does this partnership meet all three of the following requirements?		
a The partnership's total receipts for the tax year were less than \$250,000;		
b The partnership's total assets at the end of the tax year were less than \$600,000; and		
c Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.		
If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; Item F on page 1 of Form 1065; or Item N on Schedule K-1.		
6 Does this partnership have any foreign partners? If "Yes," the partnership may have to file Forms 8804, 8805 and 8813. See the instructions.		
7 Is this partnership a publicly traded partnership as defined in section 469(k)(2)?		
8 Has this partnership filed, or is it required to file, a return under section 6111 to provide information on any reportable transaction?		
9 At any time during calendar year 2005, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See the instructions for exceptions and filing requirements for Form TD F 90-22.1. If "Yes," enter the name of the foreign country. ▶		
10 During the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520. See the instructions		
11 Was there a distribution of property or a transfer (for example, by sale or death) of a partnership interest during the tax year? If "Yes," you may elect to adjust the basis of the partnership's assets under section 754 by attaching the statement described under Elections Made By the Partnership in the instructions		
12 Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return ▶		

Designation of Tax Matters Partner (see the instructions)

Enter below the general partner designated as the tax matters partner (TMP) for the tax year of this return:

Name of designated TMP ▶ _____ Identifying number of TMP ▶ _____

Address of designated TMP ▶ _____

Schedule K Partners' Distributive Share Items		Total amount	
Income (Loss)	1 Ordinary business income (loss) (page 1, line 22)	1	
	2 Net rental real estate income (loss) (attach Form 8825)	2	
	3a Other gross rental income (loss)	3a	
	b Expenses from other rental activities (attach statement)	3b	
	c Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4 Guaranteed payments	4	
	5 Interest income	5	
	6 Dividends: a Ordinary dividends	6a	
	b Qualified dividends	6b	
	7 Royalties	7	
	8 Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
9a Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a		
	b Collectibles (28%) gain (loss)	9b	
	c Unrecaptured section 1250 gain (attach statement)	9c	
10 Net section 1231 gain (loss) (attach Form 4797)	10		
11 Other income (loss) (see instructions) Type ▶	11		
Deductions	12 Section 179 deduction (attach Form 4562)	12	
	13a Contributions	13a	
	b Investment interest expense	13b	
	c Section 59(e)(2) expenditures: (1) Type ▶ (2) Amount ▶	13c(2)	
d Other deductions (see instructions) Type ▶	13d		
Self-Employment	14a Net earnings (loss) from self-employment	14a	
	b Gross farming or fishing income	14b	
	c Gross nonfarm income	14c	
Credits & Credit Recapture	15a Low-income housing credit (section 42(j)(5))	15a	
	b Low-income housing credit (other)	15b	
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468)	15c	
	d Other rental real estate credits (see instructions) Type ▶	15d	
	e Other rental credits (see instructions) Type ▶	15e	
	f Other credits and credit recapture (see instructions) Type ▶	15f	
Foreign Transactions	16a Name of country or U.S. possession ▶	16a	
	b Gross income from all sources	16b	
	c Gross income sourced at partner level	16c	
	Foreign gross income sourced at partnership level		
	d Passive ▶ e Listed categories (attach statement) ▶ f General limitation ▶	16f	
	Deductions allocated and apportioned at partner level		
	g Interest expense ▶ h Other ▶	16h	
	Deductions allocated and apportioned at partnership level to foreign source income		
i Passive ▶ j Listed categories (attach statement) ▶ k General limitation ▶	16k		
l Total foreign taxes (check one): ▶ Paid <input type="checkbox"/> Accrued <input type="checkbox"/>	16l		
m Reduction in taxes available for credit (attach statement)	16m		
n Other foreign tax information (attach statement)			
Alternative Minimum Tax (AMT) Items	17a Post-1986 depreciation adjustment	17a	
	b Adjusted gain or loss	17b	
	c Depletion (other than oil and gas)	17c	
	d Oil, gas, and geothermal properties—gross income	17d	
	e Oil, gas, and geothermal properties—deductions	17e	
	f Other AMT items (attach statement)	17f	
Other Information	18a Tax-exempt interest income	18a	
	b Other tax-exempt income	18b	
	c Nondeductible expenses	18c	
	19a Distributions of cash and marketable securities	19a	
	b Distributions of other property	19b	
	20a Investment income	20a	
b Investment expenses	20b		
c Other items and amounts (attach statement)			

Analysis of Net Income (Loss)

1 Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 16i						1
2 Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt organization	(vi) Nominee/Other
a General partners						
b Limited partners						

Note: Schedules L, M-1, and M-2 are not required if Question 5 of Schedule B is answered "Yes."

Schedule L	Balance Sheets per Books	Beginning of tax year		End of tax year	
		(a)	(b)	(c)	(d)
Assets					
1	Cash				
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts				
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities				
6	Other current assets (attach statement)				
7	Mortgage and real estate loans				
8	Other investments (attach statement)				
9a	Buildings and other depreciable assets				
b	Less accumulated depreciation				
10a	Depletable assets				
b	Less accumulated depletion				
11	Land (net of any amortization)				
12a	Intangible assets (amortizable only)				
b	Less accumulated amortization				
13	Other assets (attach statement)				
14	Total assets				
Liabilities and Capital					
15	Accounts payable				
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach statement)				
18	All nonrecourse loans				
19	Mortgages, notes, bonds payable in 1 year or more				
20	Other liabilities (attach statement)				
21	Partners' capital accounts				
22	Total liabilities and capital				

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

1	Net income (loss) per books	6	Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):
2	Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):	a	Tax-exempt interest \$
3	Guaranteed payments (other than health insurance)	7	Deductions included on Schedule K, lines 1 through 13d, and 16i, not charged against book income this year (itemize):
4	Expenses recorded on books this year not included on Schedule K, lines 1 through 13d, and 16i (itemize):	a	Depreciation \$
a	Depreciation \$		
b	Travel and entertainment \$	8	Add lines 6 and 7
5	Add lines 1 through 4	9	Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5

Schedule M-2 Analysis of Partners' Capital Accounts

1	Balance at beginning of year	6	Distributions: a Cash
2	Capital contributed: a Cash	b	Property
	b Property	7	Other decreases (itemize):
3	Net income (loss) per books		
4	Other increases (itemize):	8	Add lines 6 and 7
5	Add lines 1 through 4	9	Balance at end of year. Subtract line 8 from line 5

Schedule K-1 (Form 1065)

2005

Department of the Treasury Internal Revenue Service

For calendar year 2005, or tax year beginning ... 2005 ending ... 20...

Final K-1 Amended K-1

OMB No. 1545-0099

Partner's Share of Income, Deductions, Credits, etc.

See back of form and separate instructions.

Part I Information About the Partnership

Form section for Part I: A Partnership's employer identification number, B Partnership's name, address, city, state, and ZIP code, C IRS Center where partnership filed return, D Check if this is a publicly traded partnership (PTP), E Tax shelter registration number, F Check if Form 8271 is attached

Part II Information About the Partner

Form section for Part II: G Partner's identifying number, H Partner's name, address, city, state, and ZIP code, I General partner or LLC member-manager, J Domestic partner, K What type of entity is this partner?, L Partner's share of profit, loss, and capital, M Partner's share of liabilities at year end, N Partner's capital account analysis

Part III Information About the Partner's Share of Income

Table with 4 columns: Line number, Description, Line number, Description. Rows include Ordinary business income (loss), Net rental real estate income (loss), Other net rental income (loss), Guaranteed payments, Interest income, Ordinary dividends, Qualified dividends, Royalties, Net short-term capital gain (loss), Net long-term capital gain (loss), Collectibles (28%) gain (loss), Unrecaptured section 1250 gain, Net section 1231 gain (loss), Other income (loss), Section 179 deduction, Other deductions, Self-employment earnings (loss), Credits & credit recapture, Foreign transactions, Alternative minimum tax (AMT) items, Distributions, Tax-exempt income and nondeductible expenses, Other information

*See attached statement for additional information.

For IRS Use Only

This list identifies the codes used on Schedule K-1 for all partners and provides summarized reporting information for partners who file Form 1040. For detailed reporting and filing information, see the separate Partner's Instructions for Schedule K-1 and the instructions for your income tax return.

1. Ordinary business income (loss). You must first determine whether the income (loss) is passive or nonpassive. Then enter on your return as follows:	Code	Enter on
Passive loss	See the Partner's Instructions	
Passive income	Schedule E, line 28, column (g)	
Nonpassive loss	Schedule E, line 28, column (h)	
Nonpassive income	Schedule E, line 28, column (i)	
2. Net rental real estate income (loss)	See the Partner's Instructions	
3. Other net rental income (loss)		
Net income	Schedule E, line 28, column (g)	
Net loss	See the Partner's Instructions	
4. Guaranteed payments	Schedule E, line 28, column (j)	
5. Interest income	Form 1040, line 8a	
6a. Ordinary dividends	Form 1040, line 9a	
6b. Qualified dividends	Form 1040, line 9b	
7. Royalties	Schedule E, line 4	
8. Net short-term capital gain (loss)	Schedule D, line 5, column (f)	
9a. Net long-term capital gain (loss)	Schedule D, line 12, column (f)	
9b. Collectibles (28%) gain (loss)	28% Rate Gain Worksheet, line 4 (Schedule D Instructions)	
9c. Unrecaptured section 1250 gain	See the Partner's Instructions	
10. Net section 1231 gain (loss)	See the Partner's Instructions	
11. Other income (loss)		
<i>Code</i>		
A Other portfolio income (loss)	See the Partner's Instructions	
B Involuntary conversions	See the Partner's Instructions	
C Sec. 1256 contracts & straddles	Form 6781, line 1	
D Mining exploration costs recapture	See Pub. 535	
E Cancellation of debt	Form 1040, line 21 or Form 982	
F Other income (loss)	See the Partner's Instructions	
12. Section 179 deduction	See the Partner's Instructions	
13. Other deductions		
A Cash contributions (50%)	See the Partner's Instructions	
B Cash contributions (30%)		
C Noncash contributions (50%)		
D Noncash contributions (30%)		
E Capital gain property to a 50% organization (30%)		
F Capital gain property (20%)		
G Cash contributions (100%)		
H Investment interest expense	Form 4952, line 1	
I Deductions—royalty income	Schedule E, line 18	
J Section 59(e)(2) expenditures	See Partner's Instructions	
K Deductions—portfolio (2% floor)	Schedule A, line 22	
L Deductions—portfolio (other)	Schedule A, line 27	
M Amounts paid for medical insurance	Schedule A, line 1 or Form 1040, line 29	
N Educational assistance benefits	See the Partner's Instructions	
O Dependent care benefits	Form 2441, line 12	
P Preproductive period expenses	See the Partner's Instructions	
Q Commercial revitalization deduction from rental real estate activities	See Form 8582 Instructions	
R Pensions and IRAs	See the Partner's Instructions	
S Reforestation expense deduction	See the Partner's Instructions	
T Domestic production activities information	See Form 8903 Instructions	
U Qualified production activities income	Form 8903, line 7	
V Employer's W-2 wages	Form 8903, line 13	
W Other deductions	See the Partner's Instructions	
14. Self-employment earnings (loss)		
<i>Note. If you have a section 179 deduction or any partner-level deductions, see the Partner's Instructions before completing Schedule SE.</i>		
A Net earnings (loss) from self-employment	Schedule SE, Section A or B	
B Gross farming or fishing income	See the Partner's Instructions	
C Gross non-farm income	See the Partner's Instructions	
15. Credits & credit recapture		
A Low-income housing credit (section 42(j)(5))	Form 8586, line 4	
B Low-income housing credit (other)	Form 8586, line 4	
C Qualified rehabilitation expenditures (rental real estate)	Form 3468, line 1	
D Qualified rehabilitation expenditures (other than rental real estate)	Form 3468, line 1	
E Basis of energy property	See the Partner's Instructions	
F Other rental real estate credits	See the Partner's Instructions	
G Other rental credits	See the Partner's Instructions	
H Undistributed capital gains credit	Form 1040, line 70; check box 4	
I Credit for alcohol used as fuel	See the Partner's Instructions	
J Work opportunity credit	Form 5884, line 3	
K Welfare-to-work credit	Form 8861, line 3	
L Disabled access credit	Form 8826, line 7	
M Empowerment zone and renewal community employment credit	Form 8844, line 3	
N Credit for increasing research activities	Form 6765, line 2	
O New markets credit	Form 8874, line 2	
P Credit for employer social security and Medicare taxes	Form 8846, line 5	
Q Backup withholding	Form 1040, line 64	
R Recapture of low-income housing credit (section 42(j)(5))	Form 8611, line 8	
S Recapture of low-income housing credit (other)	Form 8611, line 8	
T Recapture of investment credit	See Form 4255	
U Other credits	See the Partner's Instructions	
V Recapture of other credits	See the Partner's Instructions	
16. Foreign transactions		
A Name of country or U.S. possession	Form 1116, Part I	
B Gross income from all sources	Form 1116, Part I	
C Gross income sourced at partner level	Form 1116, Part I	
<i>Foreign gross income sourced at partnership level</i>		
D Passive	Form 1116, Part I	
E Listed categories	Form 1116, Part I	
F General limitation	Form 1116, Part I	
<i>Deductions allocated and apportioned at partner level</i>		
G Interest expense	Form 1116, Part I	
H Other	Form 1116, Part I	
<i>Deductions allocated and apportioned at partnership level to foreign source income</i>		
I Passive	Form 1116, Part I	
J Listed categories	Form 1116, Part I	
K General limitation	Form 1116, Part I	
<i>Other information</i>		
L Total foreign taxes paid	Form 1116, Part II	
M Total foreign taxes accrued	Form 1116, Part II	
N Reduction in taxes available for credit	Form 1116, line 12	
O Foreign trading gross receipts	Form 8873	
P Extraterritorial income exclusion	Form 8873	
Q Other foreign transactions	See the Partner's Instructions	
17. Alternative minimum tax (AMT) items		
A Post-1986 depreciation adjustment	See the Partner's Instructions and the Instructions for Form 6251	
B Adjusted gain or loss		
C Depletion (other than oil & gas)		
D Oil, gas, & geothermal—gross income		
E Oil, gas, & geothermal—deductions		
F Other AMT items		
18. Tax-exempt income and nondeductible expenses		
A Tax-exempt interest income	Form 1040, line 8b	
B Other tax-exempt income	See the Partner's Instructions	
C Nondeductible expenses	See the Partner's Instructions	
19. Distributions		
A Cash and marketable securities	See the Partner's Instructions	
B Other property	See the Partner's Instructions	
20. Other information		
A Investment income	Form 4952, line 4a	
B Investment expenses	Form 4952, line 5	
C Fuel tax credit information	Form 4136	
D Look-back interest—completed long-term contracts	Form 8697	
E Look-back interest—Income forecast method	Form 8866	
F Dispositions of property with section 179 deductions	See the Partner's Instructions	
G Recapture of section 179 deduction		
H Special basis adjustments		
I Section 453(l)(3) information		
J Section 453A(c) information		
K Section 1260(b) information		
L Interest allocable to production expenditures		
M CCF nonqualified withdrawals		
N Information needed to figure depletion—oil and gas		
O Amortization of reforestation costs		
P Unrelated business taxable income		
Q Other information		