

Today's Agenda

State Conformity to New Federal Partnership Audit Rules

- 1 New Federal Rules Implementation
- 2 Background on Current State Rules
- 3 Overview of MTC Model State Statute
- 4 States' Activity (Georgia – 2018)
- 5 What to Do Now (in 2019)
- 6 AICPA Resources and Activities
- 7 Q & A
Appendix – Model Statute Details

New Federal Rules Implementation



Background – TEFRA

- In 1982, Congress passed the Tax Equity and Fiscal Responsibility Act (TEFRA)
- Partnership level determinations but **flow-through effect**.
- Partner’s treatment of item must be consistent with partnership’s treatment of item.
- Unified proceedings – all partners (supposed to be) notified of partnership audit.
- “Tax Matters Partner” (TMP) concept created to represent partnership.



Background – TEFRA

- TEFRA – PROBLEMS

- **Only .8% of large partnerships** (\$100 million in assets/100+ partners) **audited** as compared to 27.1% of corporations of the same size.
- Cumbersome and technically **complex**.
- **Statute of limitations issues** between partnership and individual partners.
- Tax Matter Partner consideration.
 - No remedy if TMP failed to notify partners of audit.
 - Difficulty in determining TMP in some cases.
 - Problems with defunct partnerships.



Bi-Partisan Budget Act (BBA) of 2015



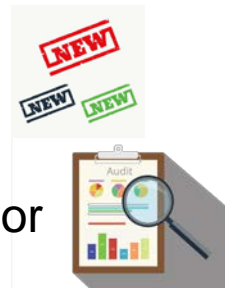
- **Eliminated TEFRA as of January 1, 2018.**
- **Put a new partnership audit structure in place - effective for years beginning after December 31, 2017.**
 - **Audit, assessment and collection occurs at the partnership level (default rule – at the entity level) – if not small partnership elect out.**
 - **Partnership audited and pays the tax on adjustments—including adjustments made to allocations between partners.**
 - **Election to push-out payment to previous partners.**
 - **Reviewed year partners liable for payment of audit assessment.**
 - **Audit adjustment reflected on amended returns for year under review.**
 - **Timing of adjustments and assessment occurs in the year audit adjustment is finalized, not year under audit.**

New BBA Audit Regime



- **New Terms Under BBA**
 - **Reviewed year** – partnership tax return year under IRS audit
 - **Adjustment year** – year in which the audit adjustment for the “reviewed year” becomes final and is taken into income
 - **Imputed underpayment amount** – Net non-favorable adjustments to the partnership tax year, multiplied by the applicable tax rate
 - **Partnership representative** - Replaces tax matters partner

New Federal Partnership Audit Process



- There is an election to “**push-out**” the responsibility to the partners for payment of the partnership tax assessment.
 - Partnership can elect to “push-out” the tax due **to the partners in the adjustment year** (resulting in no amended returns filed for the reviewed year).
 - Requires partners to make payments based on their pro rata allocation of the audit adjustments.
- The amount owed by the partnership is referred to as **the “imputed underpayment”** and is calculated by applying the highest individual or corporate income tax rate (currently, 37 percent).
- Upon the IRS providing a partnership with **a final audit adjustment**, a partnership making a “**push-out**” election **must inform the partners who were partners in the reviewed year** of the final audit adjustment.

New Federal Partnership Audit Regime

- **General –**
 - The partnership audit may **affect all partners including both direct and indirect taxpayer-partners**
 - The audit will broadly encompass all issues affected by the reporting of partnership items of income and transactions
- **IRS audits at partnership level –**
 - Large partnerships with more than 100 partners or non-taxpayer partners
 - Small partnerships not electing out
 - For the typical **audit year (“reviewed year”)** which will be **2-3 years in the past** when the audit begins
- **Every partnership must designate a partnership representative (PR)**
 - Does not need to be an individual or a partner
 - Must be a U.S. person
 - If the partnership does not have a qualified PR, the IRS may appoint one





Phase I – Partnership Audit



Phase II – Modification Period



Phase III – Partnership Pays or Pushes Out

Impact of the New Partnership Audit Rules

The major provisions of the **new partnership audit rules** are important to understand because they:

- Fundamentally **change how tax is assessed and collected** in connection with a partnership audit.
- Likely to **increase federal audits** of partnerships.
- May change the **risk analysis** in evaluating uncertain positions **for financial reporting purposes**.
- Require **changes to new and existing partnership agreements** (and LLC operating agreements), as well as other related documents (e.g., purchase and sale agreements).
- Will have **state tax implications**.



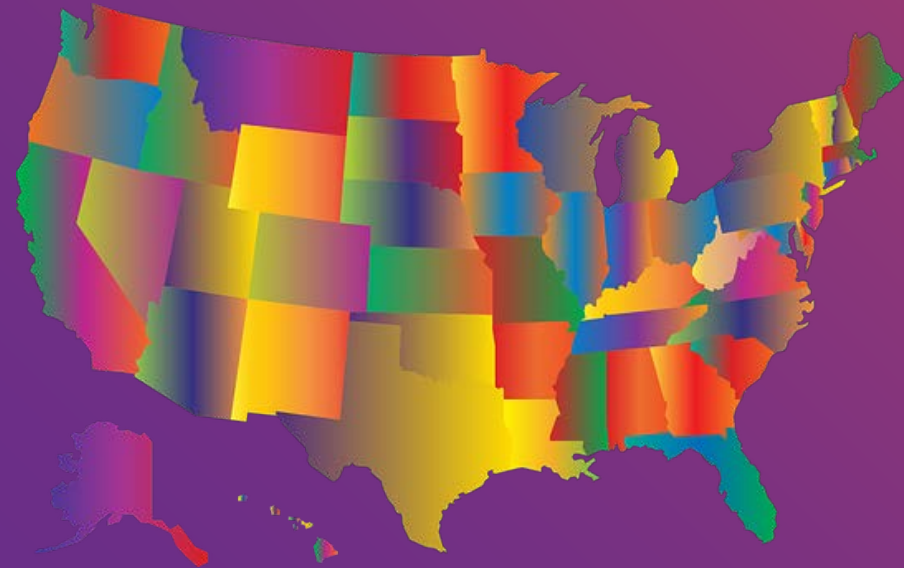
Timing of First IRS Audits under New Regime

- New regime applies to 2018 IRS Form 1065 partnership tax returns filed in 2019.
- IRS audits under the new regime will not begin until late 2019.
- First completed IRS audits are unlikely to occur until late 2020 or early 2021.
- States should have sufficient time to establish any necessary guidance or procedures before any audits are completed at the federal level under the new regime.



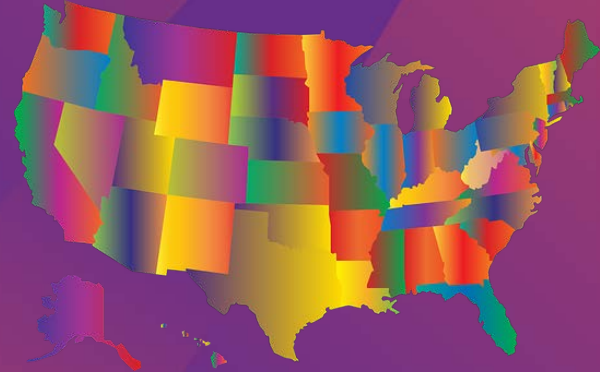
Need for Model Statute

- Background on Current State Rules for Reporting Federal Audit Adjustments



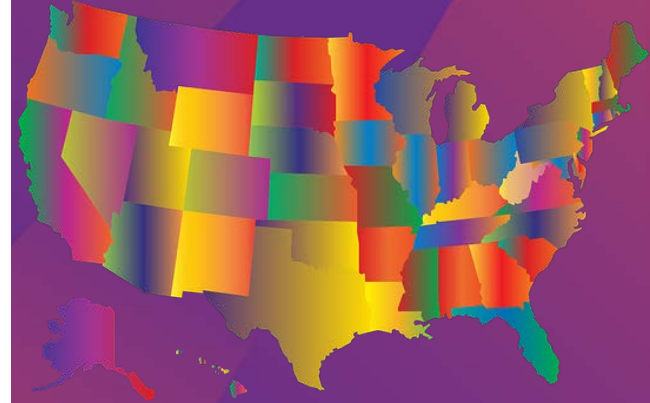
State Reporting Inconsistencies

- **Federal partnership audit regime** changes.
- **No uniform notification period** for reporting federal adjustments.
- **No consistent method for reporting** to state authorities federal tax examination adjustments and their effect on state tax liability.
- Large **compliance burdens** for taxpayers, CPAs, and state tax authorities.



Current State Environment

- **16 states do not specify the form** the report should take.
- **12 states require** the taxpayer to file an **amended state return.**
- **Several states suggest, but don't require, using an amended return** as a reporting mechanism.



Reporting Federal Audit Adjustments: Background

- **States use federal taxable income**, and other federally determined amounts, **for computing state taxable income**. If underreport federal income, also owe state tax.
- This process allows **states to benefit from federal audit** efforts.
- Federal (IRS) audits can take years – audits generally extend beyond normal federal and state statute of limitations.
- IRS audit issues are often resolved at different times, with some issues creating refunds and others creating liabilities.
- Some IRS audit adjustments have no impact at the state level (e.g., some federal credit adjustments).



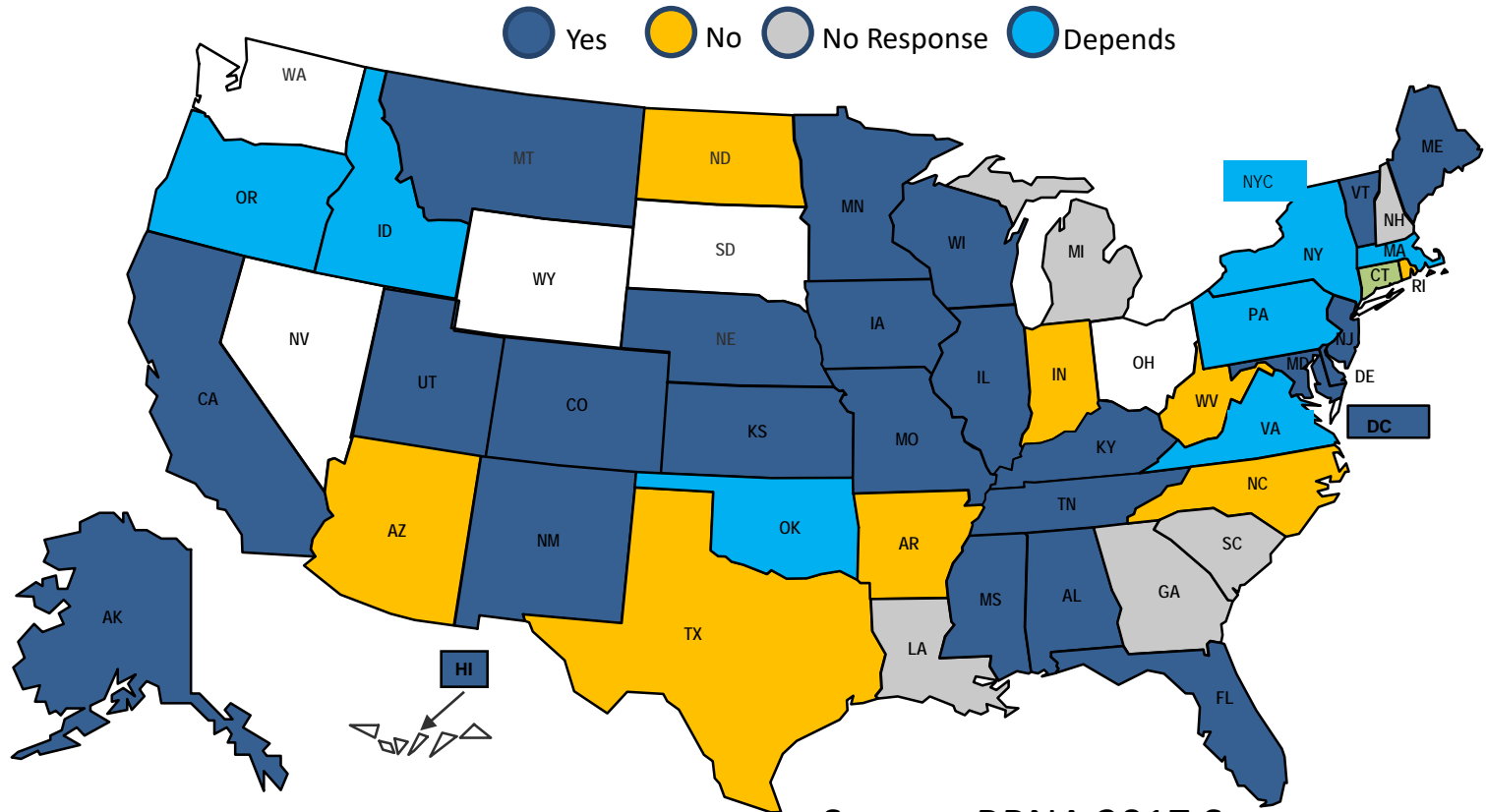
Reporting Federal Audit Adjustments: Background

“Final Determination”

- ▶ The events triggering the reporting of federal audit adjustments currently vary widely at the state level.
 - Definition of final determination varies.
 - Some states require adjustments to be reported as settled – serial reporting.
 - Other states only require reporting after all adjustments are final.
- ▶ The method to report federal audit adjustments varies widely.
 - Full amended return.
 - Other state specific notice requirements (e.g., simplified amended return or other written notification).
 - State specific spreadsheet or template.



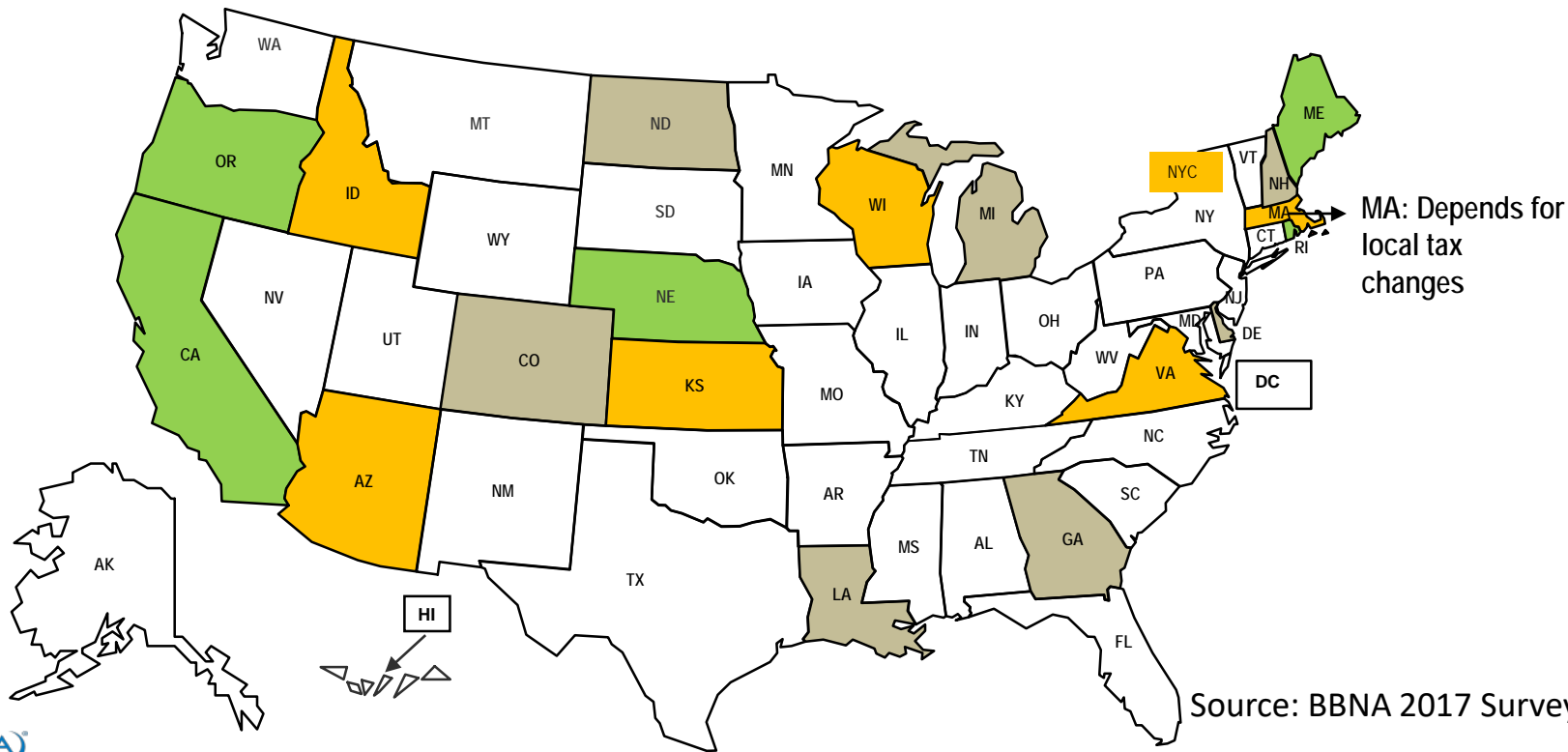
States That Require Filing/Payment Based on Partial Settlement



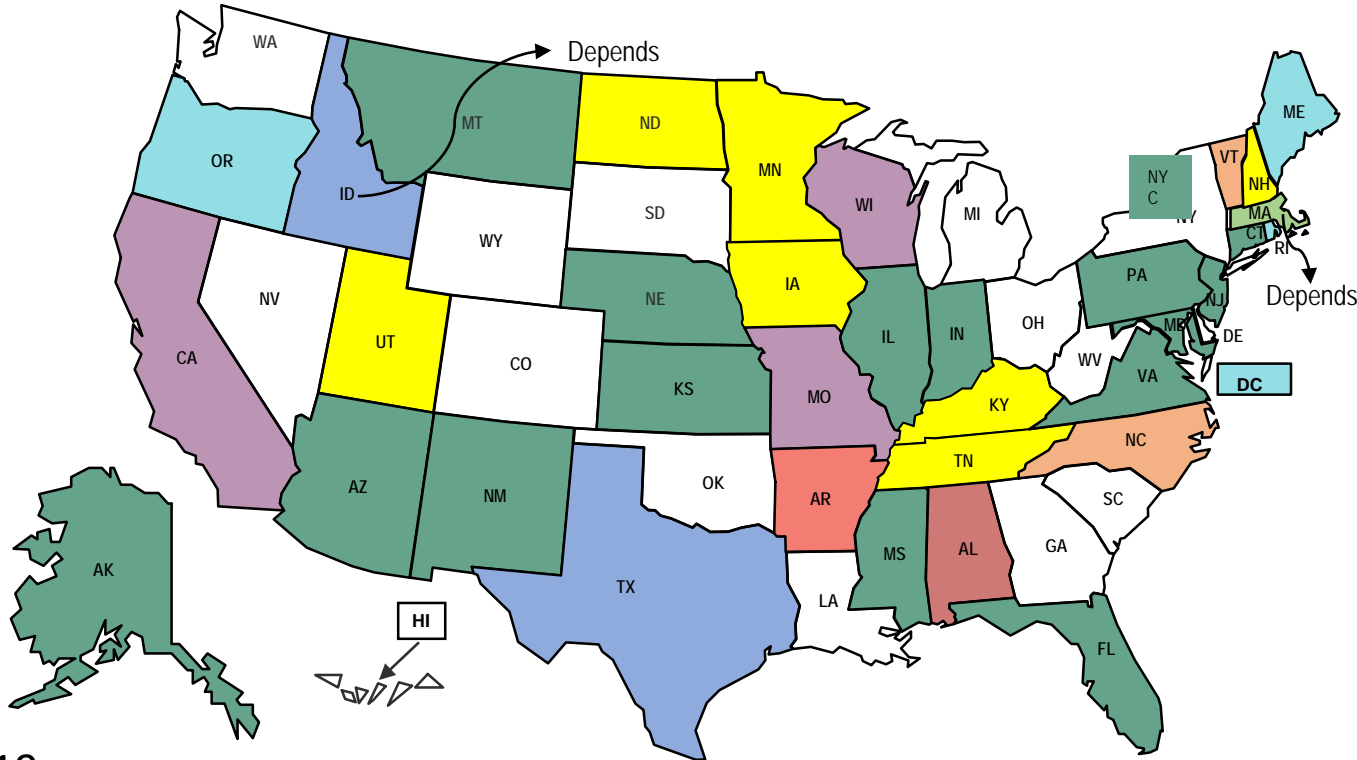
Source: BBNA 2017 Survey

States That Require Filing Based on Other State and Local Tax Agency Adjustment

- No Response
- States that require filing based on other state AND local tax agency adjustment
- States that require filing based on other state tax agency adjustment



States That Require Return & Those That Allow Writing or Imputed Filing



Adequate notice of a reportable adjustment is only made when a taxpayer **actually files** an amended return

Adequate notice of a reportable adjustment may be made when a taxpayer files some type of **notice in writing** to the agency

Adequate notice of a reportable adjustment is only made when a taxpayer **files an amended return** and may be made when a taxpayer files **notice in writing** to the agency

Adequate notice of a reportable adjustment is **imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

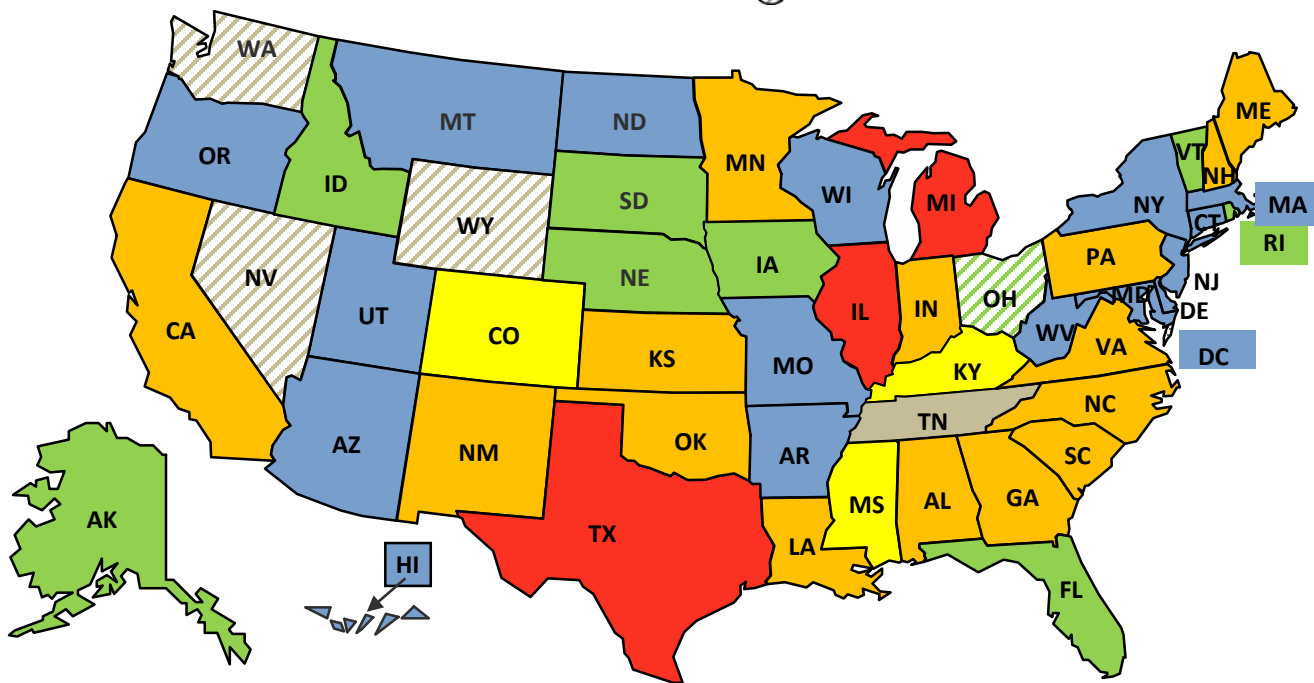
Adequate notice of a reportable adjustment may be made when a **taxpayer files notice in writing and is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment is only made when a **taxpayer actually files an amended return and is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment is only made when a taxpayer **files an amended return** and may be made when a taxpayer **files notice in writing to the agency and is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

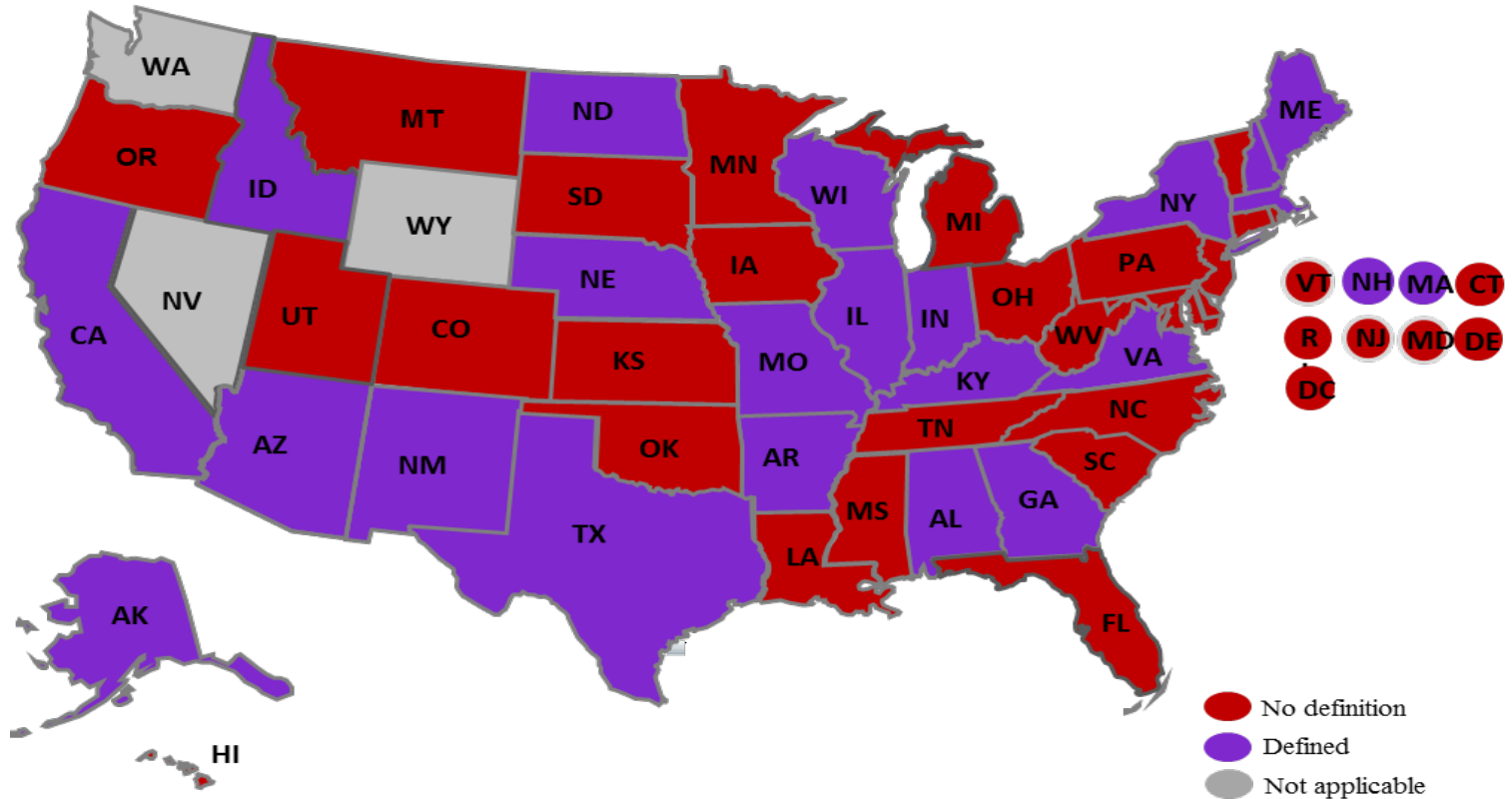
When Do Taxpayers Have to File

- Report Changes within 30 days
- Report Changes within 60 days
- Report Changes within 90 days
- Report Changes within 120 days
- Report Changes within 180 days or longer
- No statutory time limit to report federal changes
- No Corporate Income Tax



Notes
 CA: Within 6 months
 IA: 60 days for payment, 180 days for refund
 NH: Within 6 months
 NY: 120 days for combined reports
 OH: No state CIT; post-TY 2015, 60 days for amended municipal income tax returns
 OK: Within one year
 OR: 60 days if Portland/Multnomah County
 PA: Within 6 months (Tax Years pre-2013, 30 days)
 VA: Within one year.

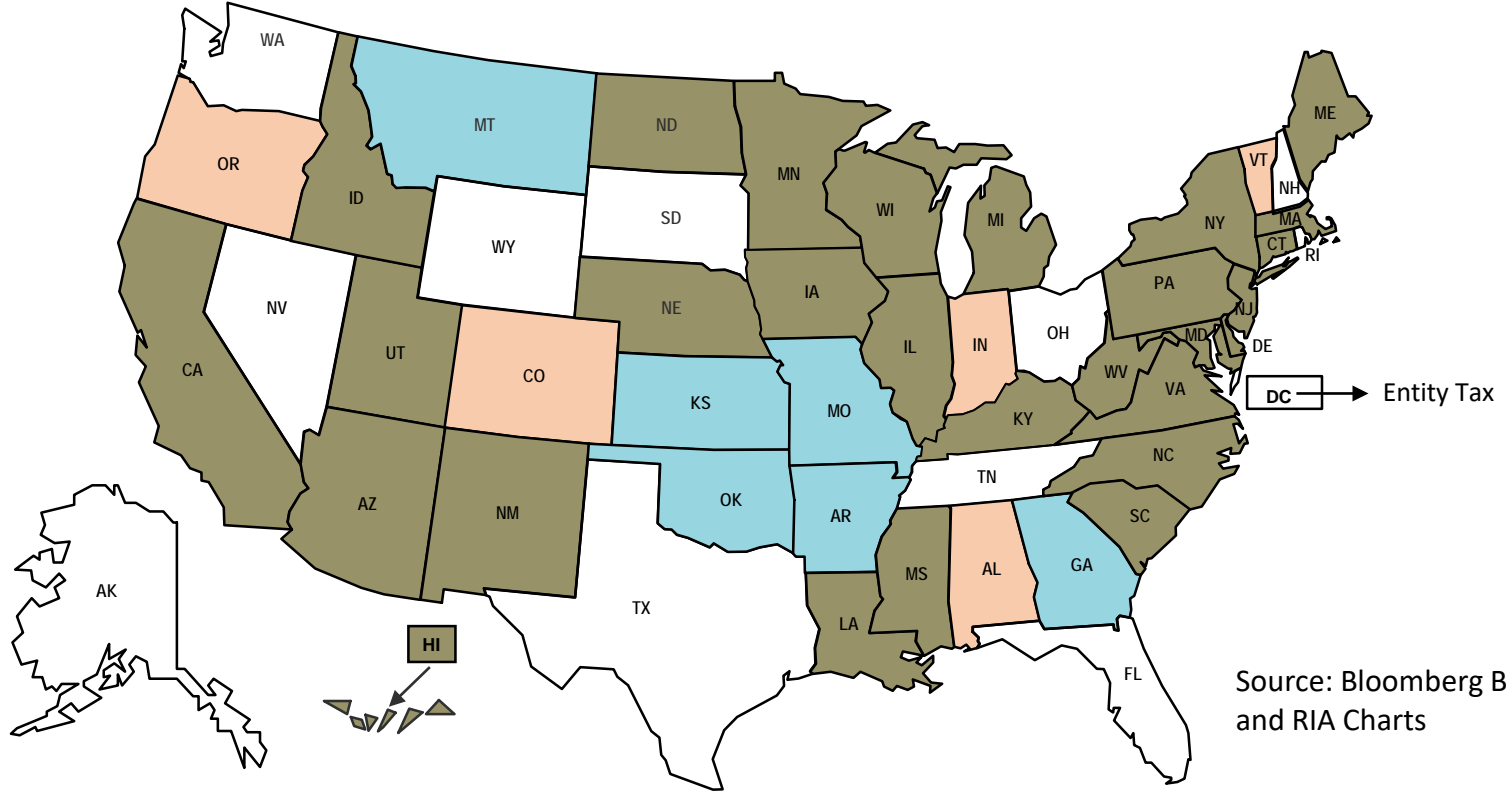
States with Definition of a “Final Determination”



Source: COST Administrative Scorecard, December 2016

Composite Returns for Corporations

Optional Required* Not Permitted

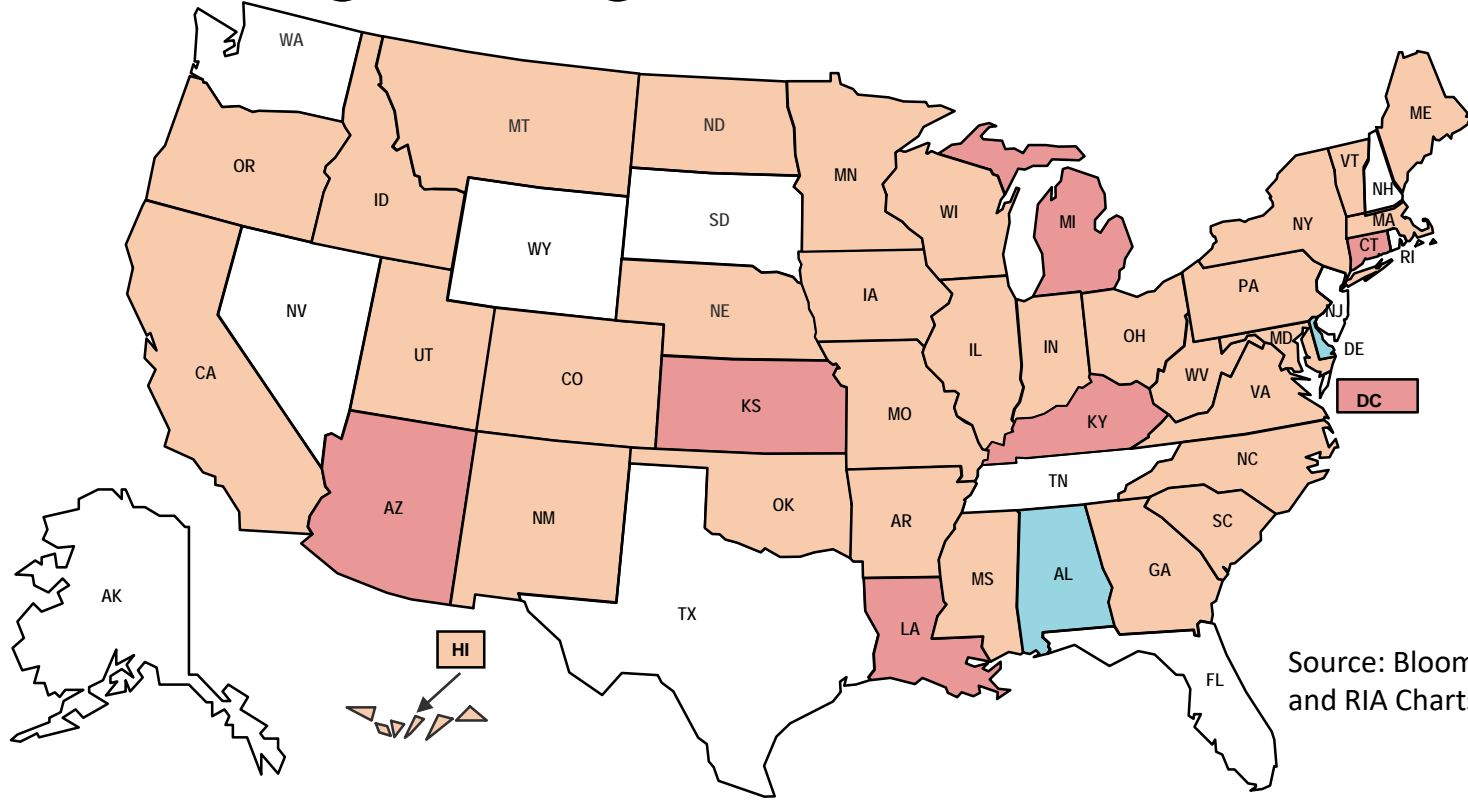


Source: Bloomberg BNA and RIA Charts

*Required returns may be limited to certain circumstances

Withholding for Individuals

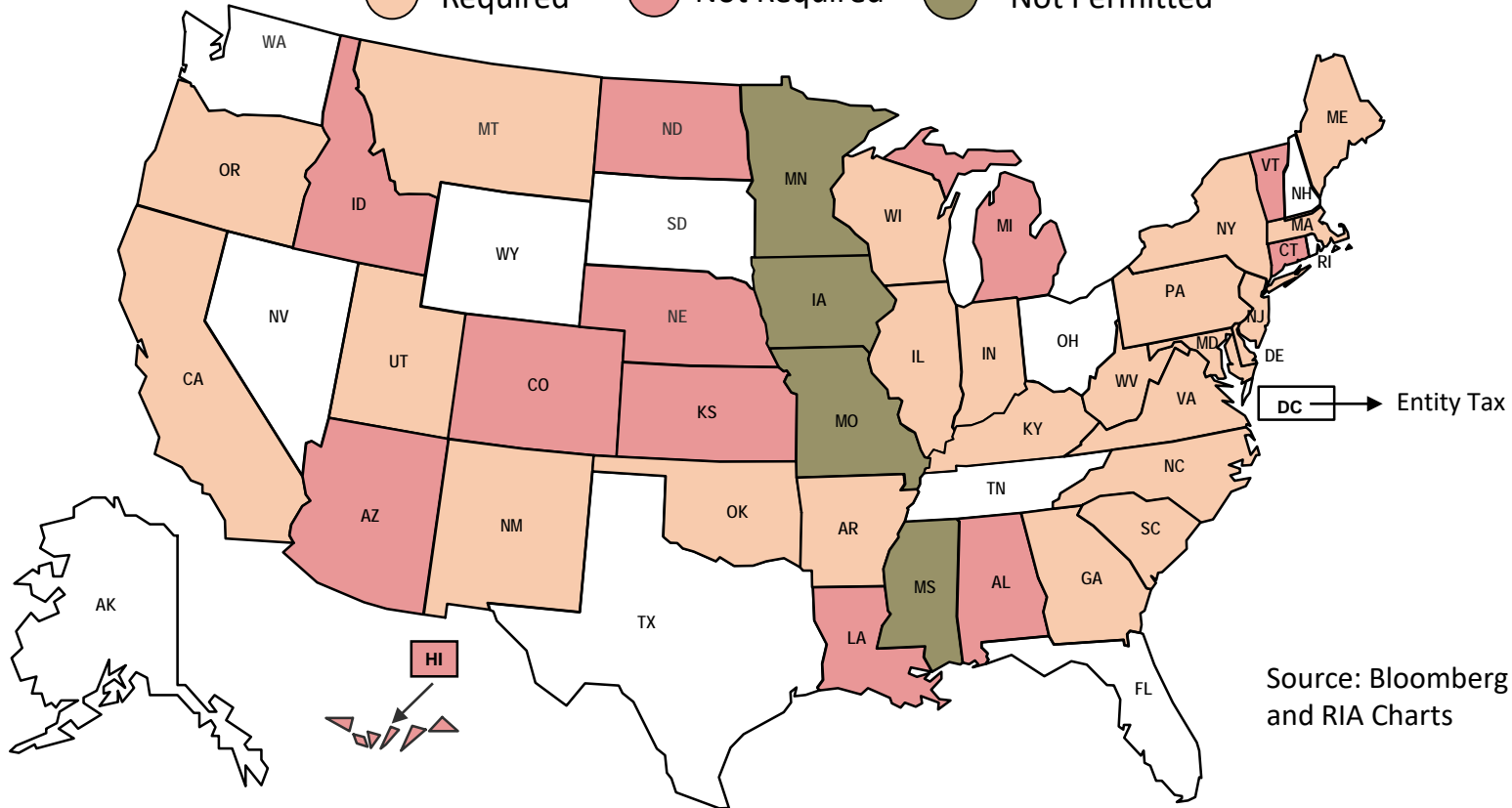
Optional Required* Not Required



Source: Bloomberg BNA and RIA Charts

Withholding for Corporations

Required* Not Required Not Permitted



Source: Bloomberg BNA and RIA Charts

*Required withholding may be limited to certain circumstances

Reporting Federal Audit Adjustments: Background

- **Multistate Tax Commission (MTC) had a Model Statute** for states – requiring taxpayers to report federal audit adjustments.
 - Model **adopted in 2003** when all states already had some type of reporting requirement in place.
 - **Model needed updating** to address changes in IRC and IRS audit procedures.
 - Taxpayer groups worked to inform state legislators of the **need for uniformity**.
- The time to report federal audit adjustments to states varies widely - ranges from no set date to one year.



Reporting Federal Audit Adjustments: Opportunities for Enhancements

- **Uniformity alone will aid taxpayers and improve compliance.**
 - 180 days allows for more accurate reporting.
 - Clear Final Determination Date that requires one time reporting federal tax changes is more efficient for tax agencies and taxpayers.
- **Many federal audit adjustments are *de minimis*; however, most states still require full reporting.**
- **Difficult for taxpayers to make “estimated payments”**
 - States unnecessarily wait for tax payments from taxpayers.
 - Taxpayers are subject to interest on under-remitted amounts.
- **Streamlined reporting will enable taxpayers to report adjustments more quickly and accurately.**

New Federal Regime Leads to State Questions

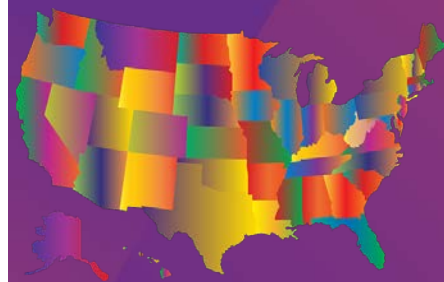


The states will need to address:

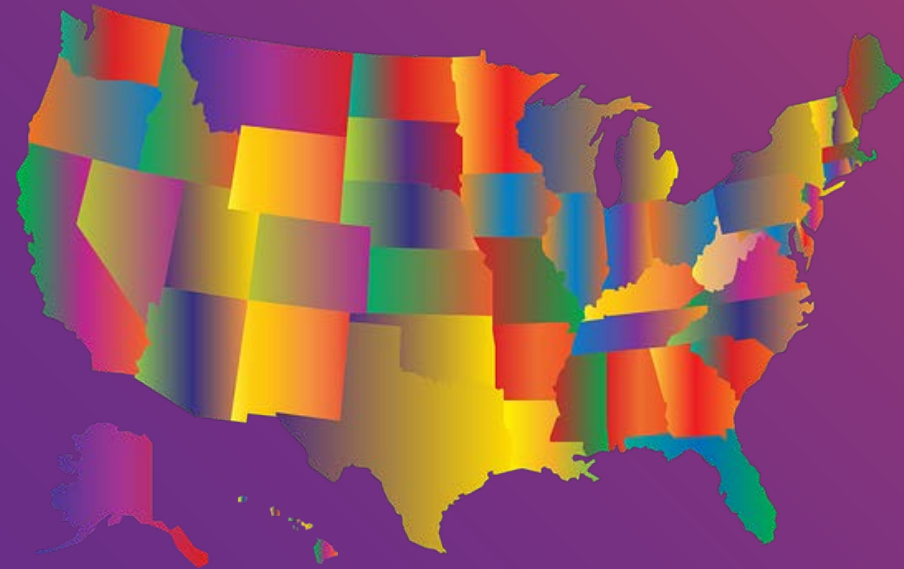
- How to **treat partnerships that elect to pay** the tax at the federal level.
- Whether to **allow different treatment at the state level**.
- Can **partnerships simply file amended returns** (entity returns along with any composite or withholding returns) and K-1s for partners and have partners file amended returns for the reviewed year.
- Other issues – **allocation and apportionment** of federal adjustments.
- **How to collect tax owed** when the liability will have occurred years earlier and the partnership may be defunct or **partners may have moved from the state**.

States Likely Need to Amend Their Laws

- The new federal law and process for federal audits of partnerships will likely **require states to amend their laws to ensure their tax agencies can administer their state taxes in conjunction** with the new federal regime.
- In order for **a state to collect its share of liabilities** flowing from an Internal Revenue Service (IRS) partnership audit **and not face substantial legal and administrative concerns**, the state should adopt the model statute.
- If the states do not adopt the model statute, there is **potential for substantial variance across** the nation as states consider legislation.



Overview of Model Statute on RAR and State Partnership Audits



MTC State Partnership Audits Model Statute

The [model statute](#):

- Provides states with a **uniform, simplified method** to apply the results of a partnership audit conducted by IRS under new federal procedures in effect for tax years starting 1/1/18.
- Provides certainty, consistency, and uniformity, and it **incorporates the changes needed for states to conform to the new federal partnership audits regime** (Regime).
- Establishes more **uniform standards for reporting federal audit adjustments for ALL taxpayers to the states**.
- Addresses the changes made to federal audit procedures by the Regime that **impact state specific issues**, such as **residency and apportionment**.



State Issues Addressed in Model Statute

- Election out at the state level
- Role and authority of partnership representative
- Modifications of imputed underpayment
- State-level partnership election to “push-out” adjustment
- Nexus and residency issues
- Apportionment and allocation calculations
- Timing of reporting obligations
- RAR statutes and authority to require amended returns
- Statute limitations



Goals of State Adoption of the Model Statute

- Broad state adoption of the model statute will provide:
 - **Greater uniformity** among the states.
 - **Increased compliance**, which will ensure states receive taxes owed quicker and with greater accuracy.
- The goal is to have **fair, reasonable, and administrable state partnership audit rules** that minimize the complexities and burdens for taxpayers, CPAs, and state tax authorities.
- The model statute is designed to **work irrespective of which options are selected** by a partnership within the new federal process.



Guiding Principles of the Model Statute

Guiding principles of the model statute and issues that **state CPA societies may want to consider** as they work with state legislatures and tax authorities:

- Allow a partnership the **ability to make different elections** under the regime **for state purposes** than the partnership makes for federal tax purposes.
 - However, recommend states require partnerships that **elect out of the regime at the federal level also to opt out at the state level.**
- Base the apportionment and allocation of the federal adjustment on the **apportionment and allocation factors of the reviewed year (adjusted for any federal audit changes).** State-specific tax treatment of items based on the reviewed year apportionment factor.



Guiding Principles of the Model Statute

- Where the partnership elects to pay the tax, apply **apportionment factors at the partnership level for all adjustments allocable to all partners except direct resident partners**
- For tiered structures, allow **flexibility and options to each tier** for reporting and payment elections that mirror the federal options.
- For administrative ease, **offer partnerships the ability to use alternative reporting and payment solutions** subject to state approval.



Guiding Principles of the Model Statute

- Provide for a **single partnership representative for all states** regardless of the state of residence of the partnership representatives.
 - **One partnership representative should apply for both federal and state purposes.**
 - The federal partnership representative may **designate a state-specific partnership representative for each state.**
- Model statute is a result of **negotiations between the AICPA and other organizations with MTC and many of the state departments of revenue** were involved in various drafts over the past two years.



Model Statute - Overview



Model Uniform Statute and Regulation for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments

Section A—Definitions

Section B—Reporting Adjustments to Federal Taxable Income – General Rule

Section C—Reporting Adjustments to Federal Taxable Income – Partnership Level Audit and Administrative Adjustment Request

Section D—DeMinimis Exception

Section E—Assessments of Additional [State] Tax, Interest, and Penalties Arising from Adjustments to Federal Taxable Income – Statute of Limitations

Section F—Estimated [State] Tax Payments During the Course of a Federal Audit

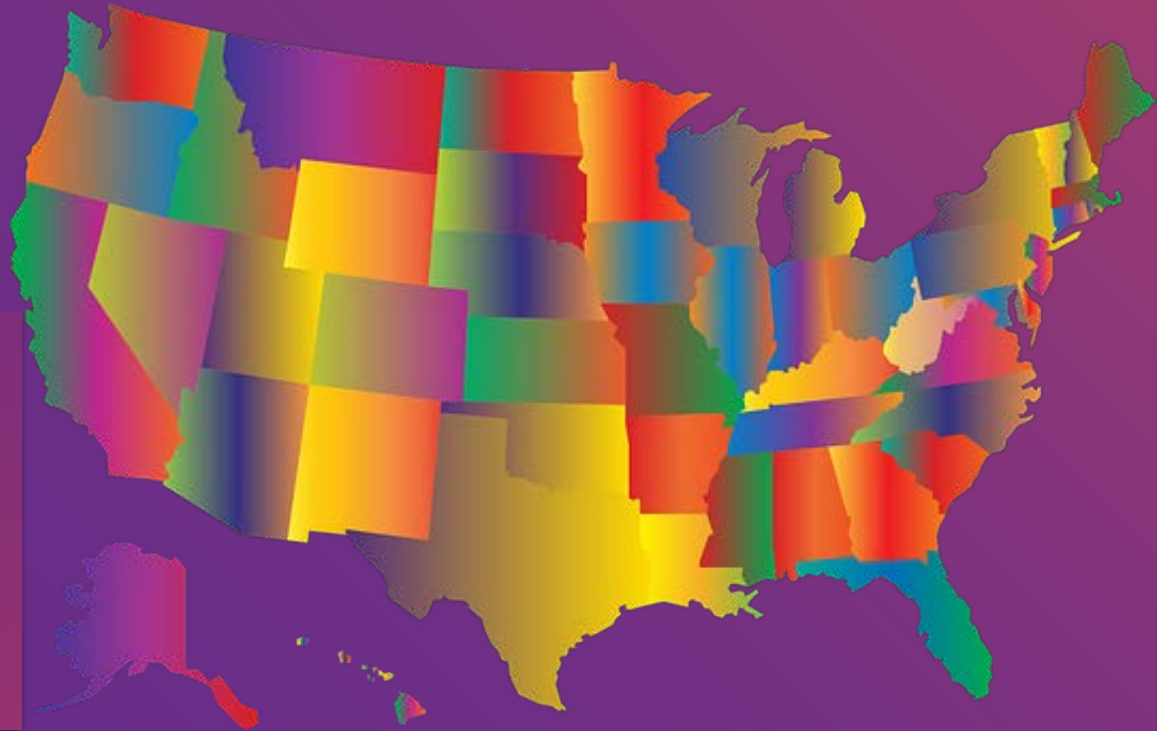
Section G—Claims for Refund or Credits of [State] Tax Arising from Final Federal Adjustments Made by the IRS

Section H—Scope of Adjustments and Extensions of Time

Section I—Effective Date



States' Activity



States' Activity

- **2016**
 - **Arizona**
 - Enacted 5/11/16.
 - S.B. 1288 is not comprehensive and does NOT follow model legislation.
 - Likely will need to be amended for IRS regulations and technical corrections legislation.
 - Will require additional rules, such as tiered partnerships not addressed.



States' Activity

- **2017**
 - Legislation considered and **NOT enacted** in 2017 not as comprehensive as the model legislation.
 - **Georgia** (H.B. 283)
 - **Minnesota** (H.F. 1227)
 - **Missouri** (S.B. 521)
 - **Montana** (H.B. No. 47)



States' Activity

- **2018**
 - **Georgia**
 - Enacted 5/3/18, H.B. 849 generally **follows the model** statute.
 - **California**
 - Enacted 9/23/18, S.B. 274 **follows to the model** statute although **the default reporting method in the bill requires a partnership** to follow the reporting and payment methodology used at the federal level, while **the model statute requires the partners to report and pay** any additional state tax on an amended return. However, the bill and the model statute allow for a **separate state election**.



States' Activity

- 2018
 - **Hawaii**
 - Enacted legislation (S.B. 2821) that does not follow model and may need to be amended
 - Hawaii statute conforms to many of the IRC provisions on the new regime, creating an audit procedure similar to the federal regime for state audits of state tax returns. However, the bill does not appear to address what the state will do following the completion of a federal audit of a partnership.
 - **Minnesota** (H.F. 3411) and **Missouri** (S.B. 897) in 2018 considered and did not enact bills that did not follow the model.

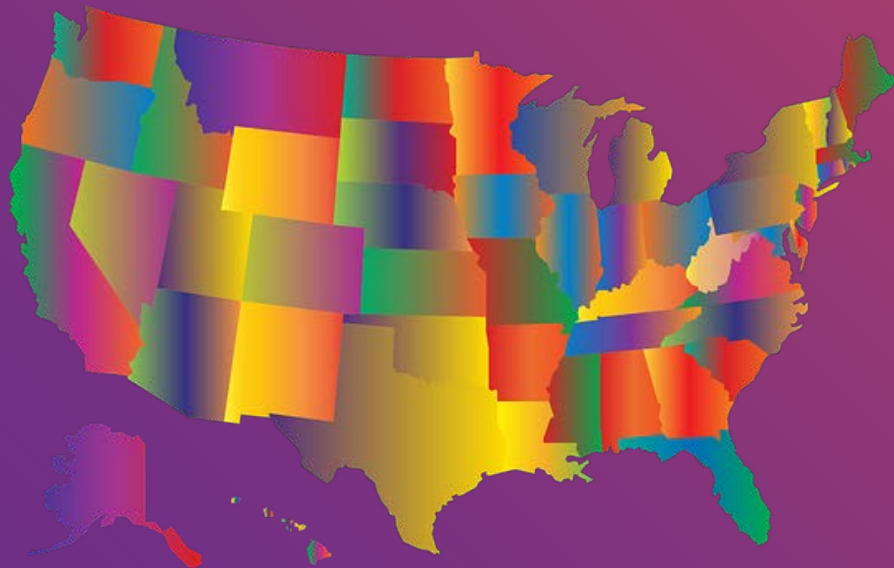


States' Activity

- **2019** – likely to be considered by:
 - **Alabama**
 - **Indiana**
 - **Kentucky**
 - **Missouri**
 - **New York**
 - **Oregon**



What to Do Now (in 2019)



**DO IT
NOW!**

What to Do Now (in 2019)

- Federal changes are expected to dramatically **increase the audit rates for partnerships.**
- The new **federal** procedures will have as the **default** the assessment and collection of tax at the **partnership level** unless certain elections and information filings are met.
- Suggest partners of firms review and consider possible **revisions to their partnership operating agreements.**
- **Address state level issues** - now that the federal issues have started to be clarified further in regulations and will soon be finalized.
- Practitioners and state societies should **review the IRS's guidance and the AICPA position paper.**



What to Do Now (in 2019)

- **State CPA societies** may want to work on the state tax issues by:
 - Undertake a process to **identify state-specific areas** that the regime will impact.
 - Develop **potential options** to address them.
 - **Encourage adoption of the state model statute.**



What to Do Now (in 2019)

- State CPA societies may want to **reach out to their state tax authority and begin a dialogue on what state-specific** concerns the state may need to address.
- Each state should decide whether it will:
 - **Conform** to the regime,
 - **Partially adopt** the new provisions, or
 - Determine the **consequences of not adopting** them.



What to Do Now (in 2019)

- The laws of many **states do not allow for the direct assessment of partnerships** as these entities are not taxpayers upon which the state may assess, collect, or levy a tax.
- In other states, the **partnership itself is the taxpayer**, and **individual assessment is not permitted** as the state may not subject individuals to state income taxes.
- Therefore, many states will **need to enact legislation** in this area, and **state tax authorities will need to issue guidance** to explain how the states will implement any changes.



What to Do Now (in 2019)

- A major issue to address is whether the **additional tax** resulting from the audit adjustment and paid by the partnership is **treated as a**:
 - **Partnership-level tax**, or
 - **Partner-level tax paid** on behalf of the partners by the partnership.
- Taxpayers and state tax administrators will need to address:
 - The corresponding **impact on basis computations**.
 - The ability of the **individuals to claim credits for taxes paid to other states** against their personal resident income tax obligations.



What to Do Now (in 2019)

- Each state will need to address the application of other **state-specific income tax issues** to partnerships and their partners, especially the effect of apportionment and allocation.
- If a state **conforms to the regime** and requires assessment, levy, and collection of a state imputed underpayment at the **partnership level**, the state will **need a mechanism to** determine what portion of that tax is **attributable to the state**.
- States typically use a system of allocation and apportionment..
 - If a state permits partnerships to push out the partnership audit adjustments to their **reviewed year partners**, similar issues exist.
 - Generally, the allocation and apportionment of the audited partnership would determine the **portion of the adjustment sourced to the state**.

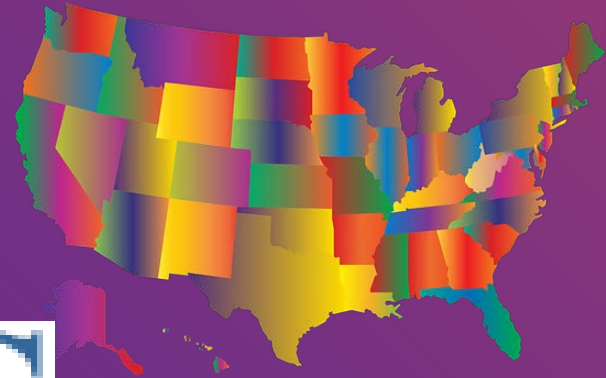


What to Do Now (in 2019)

- In some situations, however, partners are required to include their **unapportioned share of partnership income** or loss in pre-apportionment taxable income, and their **shares of the partnership's apportionment attributes** in their partner-level apportionment calculations.
 - This situation typically is when **a corporate partner owns a controlling interest** in a partnership and operates as part of a **unitary business** with the partnership.
- These issues can become especially confusing in **complex, multi-tiered partnership** structures.
- **States will need to provide detailed guidance** to taxpayers and their advisers and specify a clear path to compliance.



AICPA Advocacy
Resources,
Comments, and
Activities



AICPA Advocacy Resources on New Partnership Audit Regime

AICPA worked on:

- [Model state](#) legislation with
 - Multi-organization task force - AICPA, ABA, COST, IPT, MLPA, and TEI
 - [Multistate Tax Commission](#) (MTC) partnership project - in MTC final approval stage now
 - AICPA State Partnership Audits Task Force
 - Assisting state societies
- Technical corrections with Congress
- Federal regulations with Treasury and IRS



AICPA Advocacy Resources on State Partnership Audits

AICPA developed and issued to assist states societies:

- [Updated **policy paper** on state partnership audits](#) (9/25/18) (and prior version [3/6/17](#))
- [Updated **one-page summary** on state partnership audits](#) (9/25/18) (and prior version [3/6/17](#))
- [Policy paper](#) and [one-page summary](#) on RAR (Revenue Agent's Report) - Reporting to State Tax Authorities of Federal Tax Examination Adjustments and their Effect on State Tax Liability (3/6/17)
- AICPA working with state societies on adopting the model legislation.



Federal Legislation and AICPA Comments to Congress

- AICPA submitted comments to Congress on:
 - Technical corrections ([11/17/16](#)).
 - Delay effective date ([1/4/18](#)).
- Congress enacted technical corrections [Consolidated Appropriations Act, 2018](#) (3/23/18). **The changes enacted:**
 - Provided for a new “pull-in” procedure in lieu of partners filing amended returns.
 - Clarified that tiered partnerships may elect to use the “push-out” procedures.
 - Included definition revisions.
 - Adopted several AICPA recommendations.



Treasury and IRS Guidance

Treasury and IRS issued:

- 1/2/18 [final regulations](#) on opt-out election (T.D. 9829).
- 8/6/18 [final regulations](#) on partnership representatives and the election to apply the Regime (TD 9839).
- 8/17/18 [updated proposed regulations](#), updated for technical corrections and replaced prior proposed regulations:
 - 6/14/17 on [general rules and procedures](#).
 - 11/30/17 on [affected international tax provisions](#).
 - 12/19/17 [proposed regulations](#) on the push-out election.
 - 2/2/18 [treatment of certain tax attributes](#).



Expected Treasury and IRS Guidance on the New Federal Partnership Audit Regime

- Treasury and IRS [expected to issue more guidance](#) by 6/30/19.
 - Guidance on new partnership audit rules.
 - Final regulations on adjustments to tax bases and capital accounts.
 - Final regulations on international issues.
 - Final regulations addressing revisions to chapter 63 revisions made by the technical corrections legislation.



AICPA Comments on New Federal Partnership Audit Regime

- AICPA submitted to Treasury and IRS comments regarding the IRS regulations on:
 - [10/7/16](#) on general issues.
 - [8/14/17](#) and testimony ([9/18/17](#)) on general rules.
 - [5/16/18](#) on adjusting tax attributes.
 - [10/9/18](#) and [testimony](#) on updated 8/17/18 issued proposed regulations.



AICPA Resources on New Federal Partnership Audit Regime

- AICPA webpage on [Partnership Audit and Adjustment Rules](#)
- AICPA sample [client letter](#) on new federal rules
- The Tax Adviser articles:
 - [A Uniform State Approach to the New Federal Partnership Audit Regime](#)
 - [Developing a Uniform State Approach to the New Federal Partnership Audit Regime](#)
 - [A Glimpse into the New Partnership Audit Rules](#)



QUESTIONS

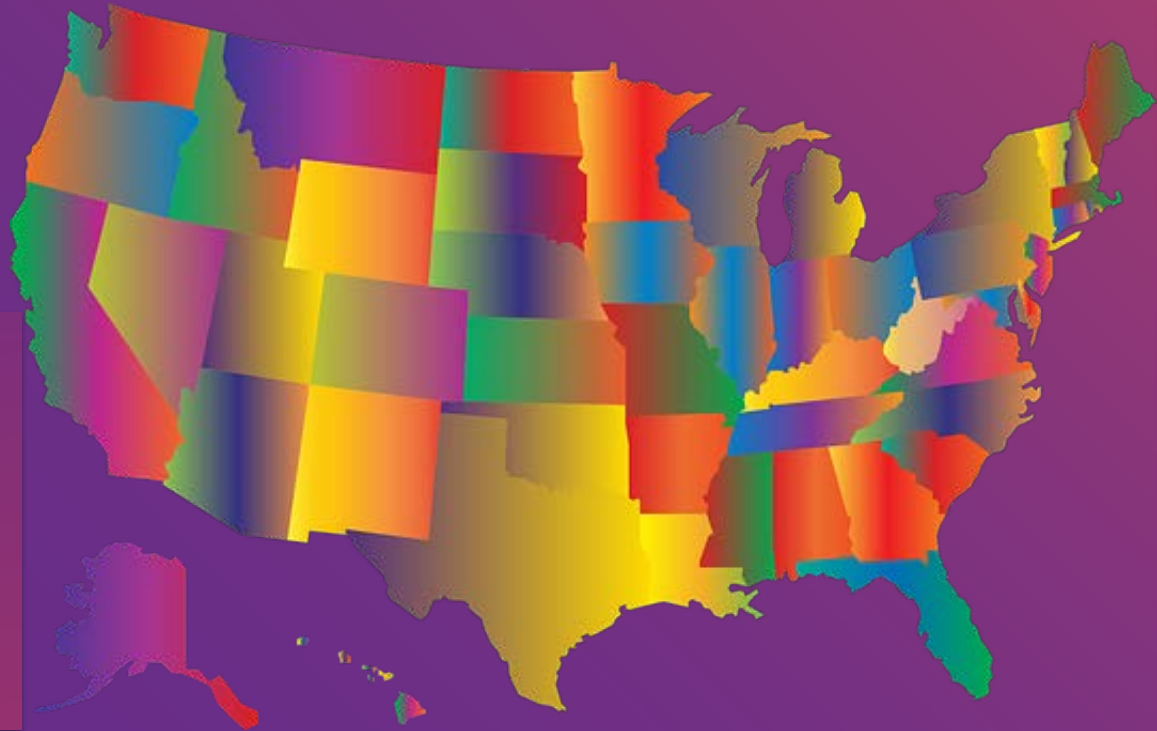


[AICPA Tax Policy and Advocacy - Website](#)

[AICPA Tax Advocacy Comment Letters - Website](#)



Appendix - Model Statute Details



Model Statute

- **Title** - Model Uniform Statute and Regulation for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments.
- **Section A** of the model statute includes the necessary **definitions** and references to the Internal Revenue Code for both the general revenue agent report (RAR) provisions and the regime-specific provisions.
 - **State CPA societies may want to work with their state's tax department to identify any existing provisions in state law or regulation that may conflict with these definitions and require modification.**



Model Statute Definitions

- **Federal adjustment**
 - Is a **change** to an item or amount determined under the Code that a taxpayer uses to **compute state tax** owed.
 - This change is regardless of whether
 - It results from action by the IRS, including a partnership level audit, or
 - Filing of an amended federal return, federal refund claim, or an administrative adjustment request by the taxpayer.
 - Can be positive or negative (increases/decreases state taxable income).



Model Statute Definitions

- **Final determination date**
 - Date all IRS adjustments to federal taxable income for the tax year are finally determined and all appeal rights under the Code are **exhausted** or have been waived; or
 - The day on which a federal amended return or similar report, federal refund claim, or federal administrative adjustment request, or other similar **report is filed**.
 - Would streamline reporting by creating **one final determination date for each tax year** under audit, which eliminates the requirement for the taxpayer to file multiple amended returns.



Model Statute Definitions

- **Final federal adjustment**
 - Is a federal adjustment after the final determination date for that federal adjustment has **passed**.
- **Federal adjustments report**
 - Method or form required by the state tax agency for a taxpayer **to report final federal adjustments**.
 - It includes an amended state tax return, information return, or a uniform multistate report.



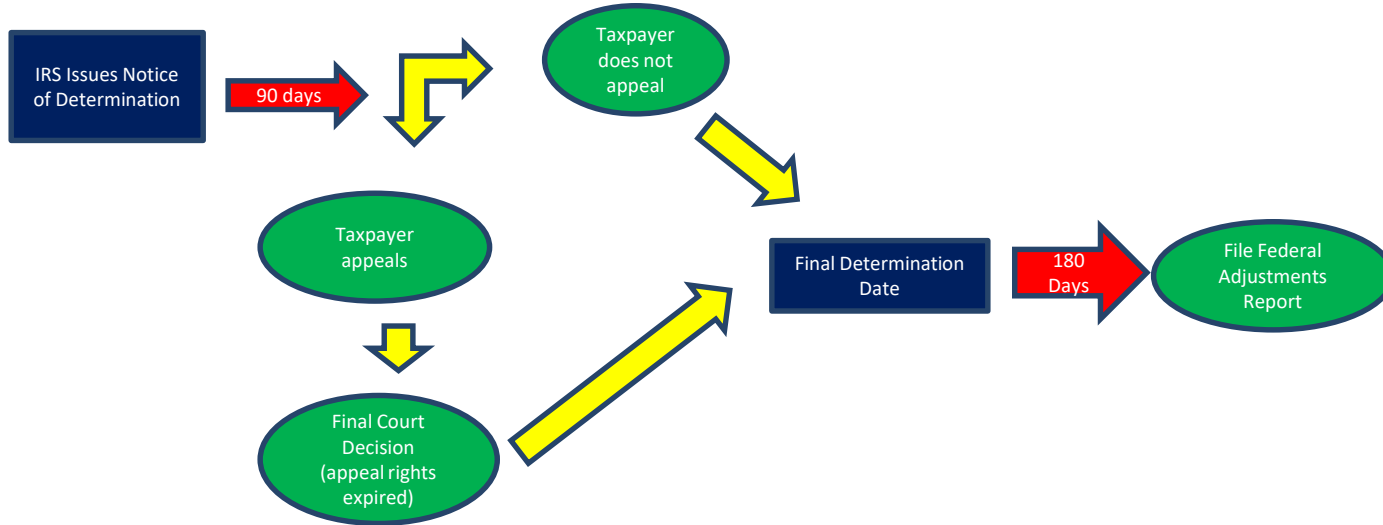
Model Statute – Reporting Adjustments

- Section B covers the **procedure for reporting adjustments** to a taxpayer's return other than those adjustments resulting from new regime partnership-level audits.
- It is intended to establish **consistency among the states** as to the timing and procedure for reporting changes resulting from IRS audits and taxpayer-prepared amended federal returns.
- The taxpayer is **required to report and pay any state tax due** with respect to a final federal adjustment **to a state within 180 days of the final determination date.**
- However, it will **not apply when a partnership elects to pay,** and for final federal adjustments required to be reported for federal purposes under Sec. 6225(a)(2).



Flow Chart Following Reporting Federal Audit Adjustment

(This is not for Partnerships subject to Partnership Level Audit)



Model Statute – Reporting Partnership Adjustments

- Section C covers new procedures **to allow states the ability to process adjustments from a federal audit conducted under the regime and collect the appropriate amount of tax** regardless of the reporting and payment options selected by the partnership at the federal level.
- **Flexibility of Elections** - certain elections are available under the regime that should **also extend to the state level**.
- The model statute provides that the **default method** used to report the changes resulting from a federal partnership audit to the state **is similar to the federal push-out method**.
 - Unlike the federal procedure, **partners would file amended returns for the reviewed (i.e., audited) year**. This default method is effectively the same as the prior procedure used following a TEFRA audit.



Model Statute – Reporting Partnership Adjustments

- Notwithstanding the default rule, the model statute also provides that **states allow partnerships to make a state-level election to pay state tax on the apportioned and allocated federal imputed underpayment at the partnership level** (and report amounts paid to individual partners) **or request a modified reporting and payment method** for use, subject to approval by the state tax authority.
- **Possibly less costly and burdensome for state agencies and taxpayers** for partnership to pay the state tax at the partnership level when the state apportionment factor is applied or state modifications are made to the federal adjustments.
- **If elect out of the regime at the federal level**, the partners **will file amended returns at the federal level** and required, under state law, **to file amended state returns** as well.



Model Statute – Reporting Partnership Adjustments

- **Apportionment and allocation factors**
 - For consistency, states base the apportionment and allocation of the federal adjustment on **the apportionment and allocation factors and rules that apply in the reviewed year, adjusted for any effects resulting from federal audit changes.**
 - States should determine the state-specific tax treatment of items based on the **reviewed year apportionment factor.**



Model Statute – Reporting Partnership Adjustments

- **Tiered structures**
 - States should allow any upper-tier partnerships in a tiered ownership structure to make a **state-level election to use the pay-up election** in the same manner as the audited partnership.
 - Under the federal regime, all partners and partnerships in a tiered ownership structure must report and pay the additional tax **due by the extended due date of the audited partnership's adjustment year.**
 - If IRS completes audit and issues a final notice on 7/1/21, the adjustment year is 2021, and extended due date is 9/15/22.



Model Statute – Reporting Partnership Adjustments

- **Tiered structures**
 - All partners and partnerships must report and pay the **additional tax due to the states no later than 90 days after the federal date** — in the example, this date is 12/15/22.
 - States are permitted to establish **interim deadlines for each tier** if desired.



Model Statute – Partnership Representative

- **Partnership Representative**
 - States should recognize for state purposes a partnership's selection at the federal level of a partnership representative.
 - Having a single individual responsible for all decisions relating to the audit, whether federal or state related, will provide **certainty and simplicity** to the process.
 - In addition, the model statute **would allow the federal partnership representative to designate a state-specific partnership representative for each state** to act in the place of the federal partnership representative for that state.
 - The federal partnership representative would coordinate all the state-specific partnership representative designations.



Model Statute – 90 Days for Filing and Notification

- **90 days for filing, notification, etc.**
 - Unless a partnership pays election is made, the general rule is that **within 90 days of the partnership's final determination date, the partnership must:**
 - **File completed federal adjustments report with state;**
 - **Notify each of its direct partners of their distributive share** of the final federal adjustment; and
 - **File an amended composite return for direct partners and/or an amended withholding return for direct partners and pay the additional amount** that would have been due had the final federal adjustments been reported properly as required.



Model Statute – 180 days for Direct Partners

- **180 days for direct partners to report distributive share and pay tax due**
- Within 180 days after the final determination date, **each direct partner that is taxed in the state must:**
 - **File a federal adjustments report** for its distributive share of the adjustments reported to the direct partner.
 - **Pay any additional amount of tax due** as if the final federal adjustments had been properly reported, plus any penalty and interest due and less any credit for related amounts paid or withheld and remitted on behalf of the direct partner.



Model Statute – Partnership Pays Election

- **Partnership pays election**
 - **A partnership can elect to pay an amount in lieu of the taxes owed by the partners.** A partnership making this partnership pays election must:
 - No later than **90 days after the final determination date, file a completed federal adjustments report with the state tax agency** and notify the state tax agency that it is making the election; and
 - No later than **180 days after the final determination date, pay an amount**, determined as described in the model statute, in lieu of taxes owed by **its direct and indirect partners.**



Model Statute – Partnership Pays Election

- **Partnership pays election**
 - The partnership payment amount includes amounts determined **for direct corporate partners** subject to tax under the state law, **nonresident direct partners** subject to tax in the state, **tiered partners**, and **resident direct partners**, along with penalty and interest as provided in state law.
 - The payment amount **excludes** from the final federal adjustments the distributive share of these adjustments reported to a **direct exempt partner not subject to tax** in the state.
 - Many other rules on partnership pays election in the model statute.



Model Statute – Modified Reporting and Payment

- **Modified reporting and payment method**
 - The model statute provides a modified reporting and payment method that states may adopt to **allow an audited partnership or tiered partner to enter into an agreement with the state agency to use an alternative reporting and payment method**, including applicable time requirements if the audited partnership or tiered partner demonstrates that the requested method will reasonably provide for the reporting and payment of taxes, penalties, and interest due under the provisions of the model statute.



Model Statute – Effect of Elections

- **Effect of election by audited partnership or tiered partner**
 - The partnership pays and the modified reporting and payment method elections **are irrevocable** unless the state agency determines otherwise.
 - The direct partners or indirect partners may not take any deduction or credit for this amount or claim a refund of the amount in this state.
 - A **direct resident partner** is not precluded from claiming a credit against taxes paid to the state under its law, for any amounts paid by the audited partnership or tiered partner on the resident partner's **behalf to another state or local tax jurisdiction** in accordance with the provisions of state law or regulation allowing credit for taxes paid to another state or locality.



Model Statute – Failure to Report or Pay

- **Failure of audited partnership or tiered partner to report or pay**
- A state agency is not prevented from **assessing direct partners or indirect partners for taxes they owe**, using the best information available, in the event **that a partnership or tiered partner fails to timely make any report or payment** required by the model statute for any reason.



Model Statute – Other Issues

- All or most of the remaining provisions already exist in many states' current tax statutes in some form.
- **States may want to consider adopting these items or modifying their existing provisions** to further the goals of uniformity, which helps ease administrative burdens and costs for both taxpayers and state tax departments
- These **remaining sections** of the model statute contain provisions cover:
- ***De minimis* exception**
 - **State agencies may issue regulations to establish a *de minimis* amount** upon which a taxpayer shall **not be required to comply** with the notification, reporting, and payment requirements in the model statute..



Model Statute – Statute of Limitations

- **Statutes of limitation on assessments and refund claims.**
 - A **state agency** may issue an assessment within the later of:
 - **One year following the filing date** with the state of the federal adjustments report, or
 - The **expiration of the general limitation period** where a taxpayer timely files a federal adjustments report.

or

- **Six years following the final determination date**, absent fraud, if the taxpayer **fails to file** the federal adjustments report within the required period, **or** the federal adjustments report filed **omits final federal adjustments** or understates the correct amount of tax owed) **and state mails notice.**



Model Statute – Estimated State Tax Payments

- **Estimated state tax payments during a federal audit**
 - **Estimated payments allowed** to the state agency prior to the due date of the federal adjustments report (i.e., during a pending IRS audit), even if no final determination yet, to stop the running of interest to the taxpayer.
 - Estimated tax payments will be **credited against any tax liability** ultimately found to be due to the state.
 - **No need to file the federal adjustments report or amended or pro forma amended tax returns.**
 - If estimated tax payments **exceed final tax liability** and statutory interest is due, **taxpayer is entitled to a refund or credit of excess**, provided taxpayer files a federal adjustments report or claim for refund or credit of tax no later than one year following the final determination date.



Model Statute – Claims for Refund or Credit

- **Claims for refund or credits of state tax arising from final federal adjustments**
- The period that a taxpayer may file a state **claim for refund** or credit of state tax is the later of:
 - **One year from the date required for filing** the federal adjustments report with the state agency under the model statute (including any extensions), or
 - The **expiration for filing a claim or credit** (including any extensions).
- A **federal adjustments report will serve as a taxpayer's claim for refund or credit of tax** and as the means for the taxpayer to report additional state tax due, and make other adjustments (including to its net operating losses) resulting from adjustments to the taxpayer's federal taxable income.



Model Statute – Scope of Adjustments

- **Scope of adjustments and extensions of time**
 - Unless a taxpayer and state taxing agency otherwise agree in writing, state adjustments made by the state agency or the taxpayer after the state's normal statutes of limitation for assessment and refund have expired **are limited to changes to the taxpayer's tax liability arising from the adjustments made by the IRS.**
 - The taxpayer and the state taxing agency **may agree in writing to extend the period for assessments** of additional tax arising from adjustments to federal taxable income, **and for filing a claim for refunds or credit** of tax.
 - An **audited partnership or tiered partner that has 10,000 or more direct partners** would receive an **automatic 60-day extension** upon written notice to the state agency.



Model Statute – Effective Date

- **Effective date**
 - States should provide a **clear effective date** for when the changes apply.
 - The amendments in the model statute apply to any adjustments to a taxpayer's federal taxable income with a final determination date occurring on or after a date specified in the state's statute.
 - A **prospective effective date** is encouraged.

