
National Conference of State Legislatures
Executive Committee Task Force on
State and Local Taxation

State Impact of Federal Partnership Changes

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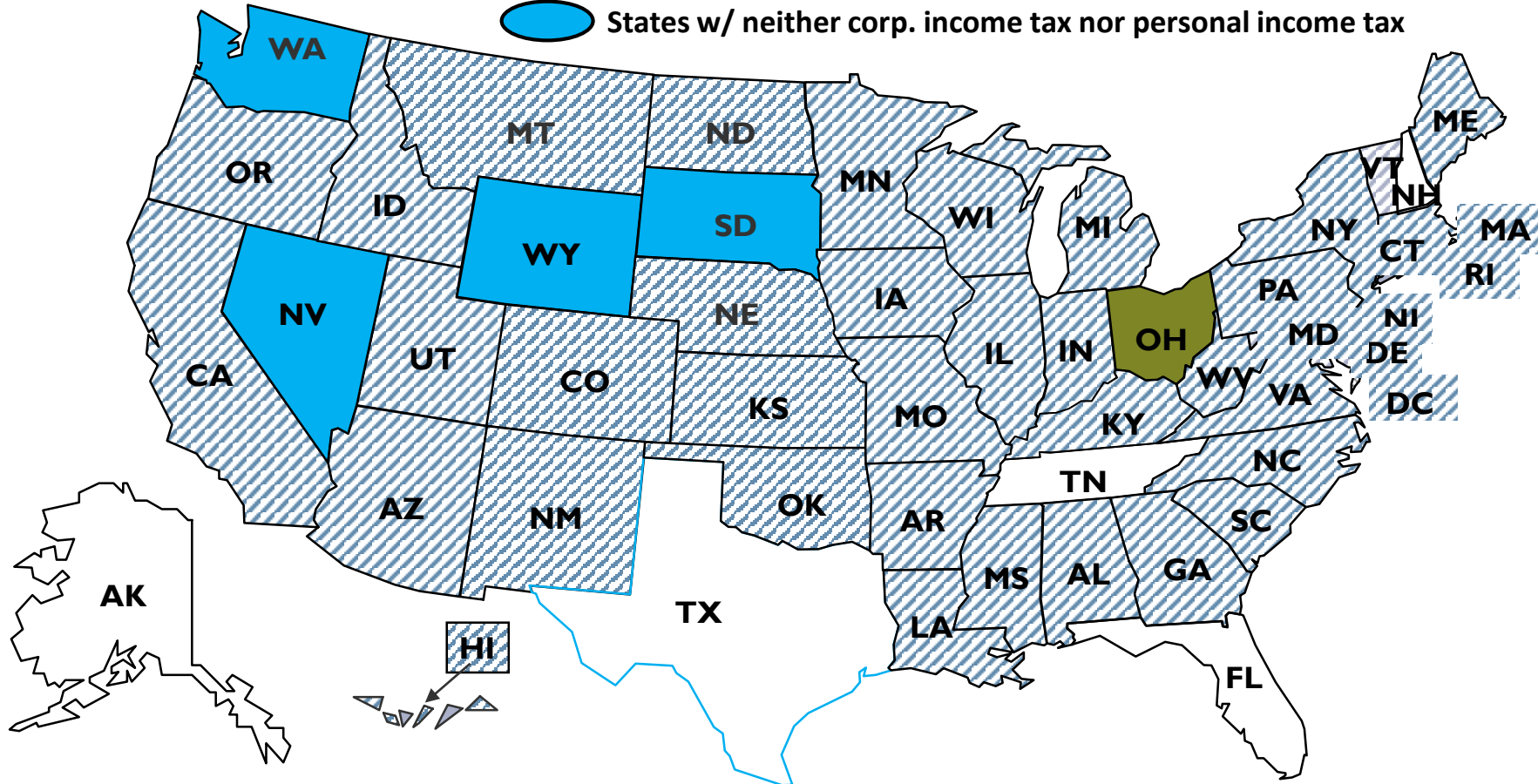
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States Impacted by the Change

-  States w/ corp. income tax & personal income tax
-  States w/ just corp. tax (note: NH imposes the BPT; TX imposes the Margin Tax; NH & TN tax interest and dividends for indiv.)
-  States with just personal income tax
-  States w/ neither corp. income tax nor personal income tax



► Importance of Uniformity

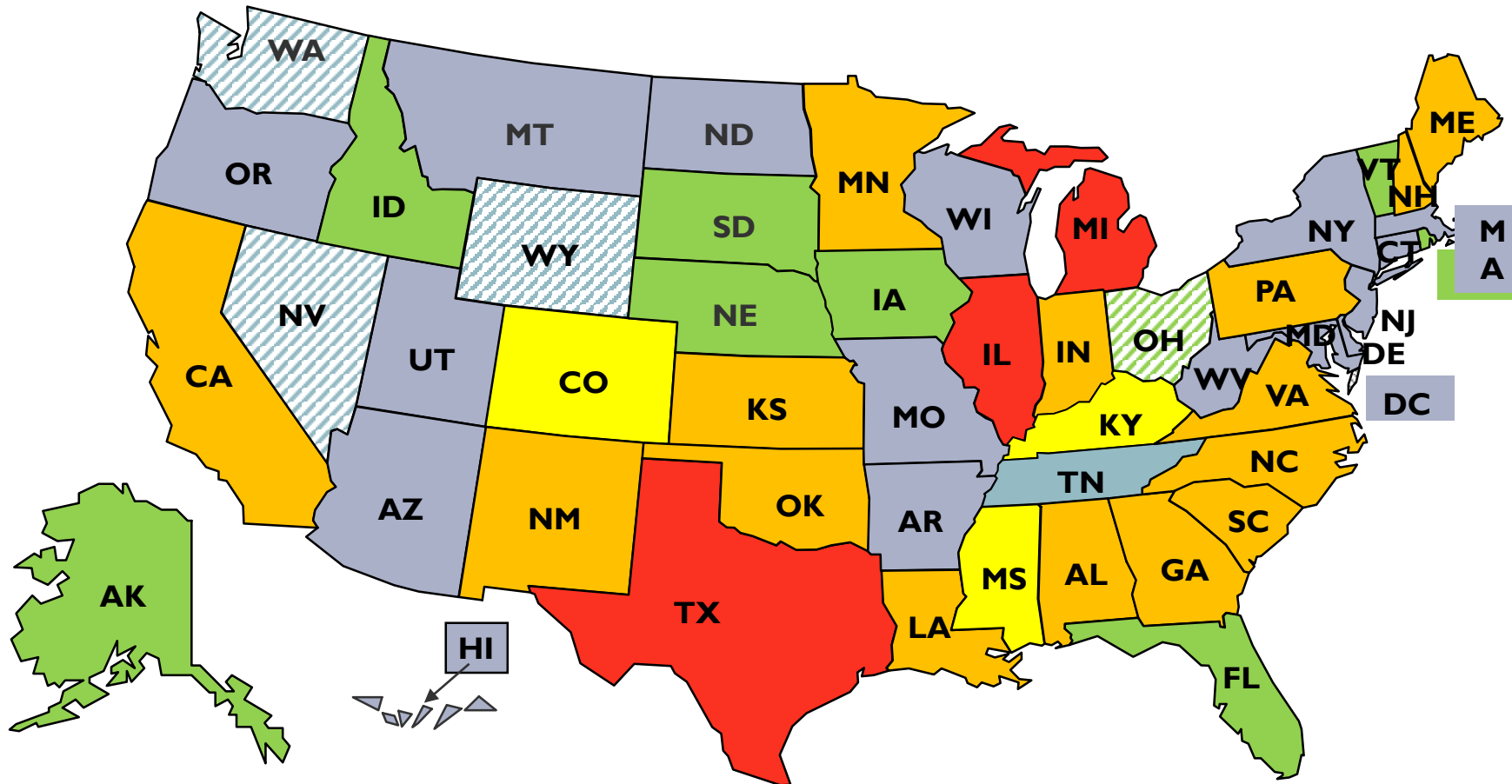
Uniformity is Key

- ▶ Multistate Tax Commission has model statutes and regulations
- ▶ Uniformity mutually reduces costs (government and taxpayers) and increases compliance

- ▶ Reporting Federal Tax Changes – Key Uniformity Provisions
 - ▶ Clear definition of Final Determination
 - ▶ No serial reporting – report when audit/appeals for tax year final
 - ▶ 180 day period to make state adjustments
 - ▶ De minimis threshold for filing/payment of tax
 - ▶ Tax changes limited to federal changes post state statute of limitations to assess

When Do Taxpayers Have to File

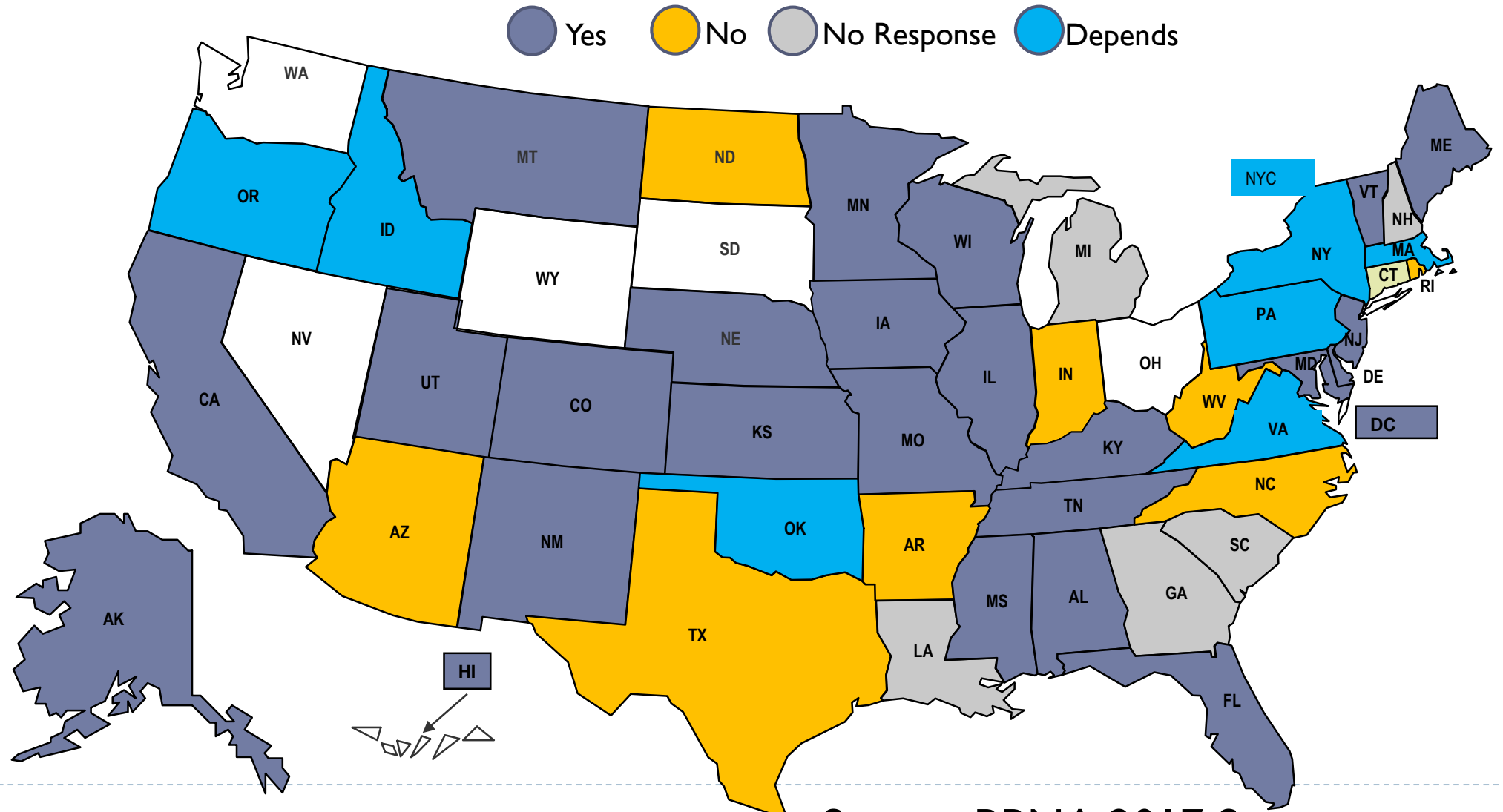
- Report Changes within 30 days
- Report Changes within 120 days
- Report Changes within 60 days
- Report Changes within 180 days or longer
- Report Changes within 90 days
- No statutory time limit to report federal changes
- No Corporate Income Tax



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 That Require Filing/Payment Based on Partial Settlement



Source: BBNA 2017 Survey

- ▶ Changes to Partnership Audit Rules:
The Centralized Audit Regime

Partnership Audit Rules Background

- ▶ The Bipartisan Budget Act of 2015 Adopted New IRS Audit Procedure for Partnerships and LLCs
 - ▶ HR 1314 (P.L. 114-74) enacted in 2015 separate from 2017 Tax Reform legislation
- ▶ The New Audit Rules For Taxable Years Beginning After December 31, 2017
 - ▶ Option to elect into the new rules for earlier years
- ▶ Expected to raise additional tax revenue by enabling the IRS to more efficiently audit partnership and LLCs
 - ▶ According to Government Accountability Office (GAO), less than one percent of large partnerships were audited during 2012, compared to a 27 percent audit rate of corporations with assets exceeding \$100 million.



Centralized Audit Regime Overview

- ▶ **Centralized Audit Regime Applies To All Partnerships and LLCs**
 - ▶ All Partnership and Operating Agreements for entities taxed as a partnership should be reviewed and amended.
- ▶ **By Default, Audit Adjustments Assessed and Collected at the Entity Level**
 - ▶ The partnership pays the tax, interest, and penalties on any “imputed underpayments” in the adjustment year (partner allocation adjustments also flow-through in adjustment year).
 - ▶ The tax due is calculated at the highest corporate or individual rate (37% in 2018).
 - ▶ Liability Mismatch: current partner group liability for former partner group underpayment
- ▶ **Replaces Tax Matters Partner With “Partnership Representative”**
 - ▶ The Partnership Representative has the sole, exclusive authority to make decisions on behalf of the p’ship in IRS audit proceedings.
 - ▶ Important decisions: audit rules elections, reporting decisions, appeal rights and decisions settlement authority, statute of limitations waivers, etc.
- ▶ ~~The Tax Matters Partner concept eliminated beginning with 2018 taxable year.~~

Centralized Audit Regime Overview

- ▶ Important Elections: There are at least three ways that partnerships may opt-out or otherwise adjust their liability under the new audit rules:
 - ▶ The True Opt-Out Election: Section 6221 Election
 - ▶ Applies only to small partnerships and must be made when return is filed
 - ▶ Voluntary Reporting During 270-Day Period: Section 6225 Reporting
 - ▶ Partners affected by a reallocation must agree to file individual amended returns; OR
 - ▶ Partnership demonstrates that a portion of the imputed underpayment is allocable to a tax-exempt entity or a C corporation or individual with LTCG or qualified dividends with a lower max. tax rate than the highest marginal rate (37% in 2018).
 - ▶ The Push-Out Election: Section 6226 Election
 - ▶ The Partnership Representative elects on behalf of the Partnership to push-out the audit adjustment to the former partner group from the year under review.



- ▶ State Issues Presented Under Federal Centralized Audit Regime

State Effects - Generally

- ▶ Issues the states need to address:
 - ▶ State procedural rules need to be amended to match the new federal audit and adjustment process
 - ▶ Whether to allow different treatment at the state level
 - ▶ How to treat amended federal returns taxpayers may file during the modification period
 - ▶ Are partnerships that pay the tax subject to state reporting requirements
 - ▶ 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?
 - ▶ Proper 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

State Effects – Apportionment/Nexus Considerations

- ▶ At the federal level, the IRS can impose tax on 100 percent of any adjustment.
- ▶ For state purposes, that adjustment needs to be apportioned and/or allocated if the partnership is operating or doing business in multiple states.
 - ▶ Many states use different apportionment rules for partnerships that are part of a unitary business
- ▶ If the partnership pays, the payment is being made on behalf of its partners.
 - ▶ Can the partnership's apportionment factor be used as a general rule?
 - ▶ How do resident individual partners calculate their credits for taxes paid to other states?
 - ▶ Does that credit apply if the partnership paid the tax in another state?
- ▶ At the federal level, the IRS has jurisdiction to collect tax from all partnerships and partners. States, however, may only impose and collect tax on taxpayers with nexus (pesky constitution!).

New Federal Partnership Audit Rules: State Implications

- ▶ MTC has an ongoing “Partnership Project” to study -
 - ▶ Do the states need to amend their tax laws to address new partnership audit procedures?
 - ▶ If so, how should those laws be revised?
 - ▶ How should the states deal with multiple-tiered entities?
 - ▶ **Website:** <http://www.mtc.gov/Uniformity/Project-Teams/Partnership-Informational-Project>
- ▶ Only Arizona has enacted legislation conforming to new federal legislation
 - ▶ Arizona’s legislation does not comprehensively address federal changes (e.g., fails to address tiered partnerships)
- ▶ Five states proposed but did not pass legislation in 2017
- ▶ Several states such as CA, GA, MN, & MO have proposals this year
 - ▶ There’s plenty of time – first returns not filed until March, 2019

- ▶ Draft Model Legislation –
Partnership Provisions

How It's Accomplished: Interested Parties

- ▶ The Interested Parties that prepared the Draft Model Statute are:
 - ▶ ABA Section of Taxation SALT Committee Task Force (ABA)
 - ▶ American Institute of CPAs (AICPA)
 - ▶ Council On State Taxation (COST)
 - ▶ Institute for Professionals in Taxation (IPT)
 - ▶ Master Limited Partnership Association (MLPA)
 - ▶ Tax Executives Institute (TEI)
- ▶ The Interested Parties have been working with the Multistate Tax Commission (MTC), this presentation based on revisions to the Draft Model Statute as of March 7, 2018
- ▶ Note: The Draft Model Statute has not yet been formally endorsed by the Interested Parties - it is a draft *for discussion purposes only*

How It's Accomplished: Key General Definitions

▶ **Federal Adjustments**

- ▶ Change to item or amount used by the taxpayer to compute state tax owed, whether resulting from an IRS audit, amended federal return, or administrative adjustment request by the taxpayer

▶ **Federal Adjustments Report (FAR)**

- ▶ Method or form required to report Federal Adjustments to state
- ▶ Includes an amended state tax return or uniform multistate report

▶ **Final Determination Date**

- ▶ For IRS audits, date on which no Federal Adjustments arising from an audit remain to be finally determined
 - ▶ For combined/consolidated returns, applies to entire group
 - ▶ For amended federal returns, refund claims, and administrative adjustment requests, the date on which the requests were filed
-

How It's Accomplished: Key Partnership Definitions

- ▶ **Direct Partner**

- ▶ Partner holding an interest directly in Partnership or Pass-Through Entity

- ▶ **Indirect Partner**

- ▶ Partner in a Partnership or Pass-Through Entity that also holds an interest in another Partnership or Pass-Through Entity

- ▶ **Resident Partner**

- ▶ Individual, trust or estate Partner domiciled in the state

- ▶ **Tiered Partner**

- ▶ Partner that itself is a Partnership or Pass-Through Entity

How It's Accomplished: Key Partnership Definitions

- ▶ **Audited Partnership**

- ▶ Partnership directly subject to Partnership Level Audit

- ▶ **Partnership Level Audit**

- ▶ BBA audit (IRC Section 6221(b))

- ▶ **Reallocation Adjustment**

- ▶ Federal Adjustment that changes the shares of partnership income, gain, loss, expense, or credit allocated to partners
 - ▶ Positive reallocation adjustment increases income owed by Partner
 - ▶ Negative reallocation adjustment decreased income owed by Partner

How It's Accomplished: Reporting Federal Adjustments for Partnership Level Audits – Default Rule

- ▶ For Reviewed Years, Audited Partnership shall:
 - ▶ **Within 90 days** of the Final Determination Date
 - ▶ File a Federal Adjustments Report;
 - ▶ Notify Direct Partners of their distributive share adjustments; and
 - ▶ File amended composite/withholding returns and pay the related tax liability on behalf of such partners
 - ▶ **Within 180 days** of the Final Determination Date, excluding Tiered Partners, each Direct Partner
 - ▶ File an Federal Adjustment Report to the state; and
 - ▶ Pay the additional tax, including penalty and interest, to the state (less any applicable credits)

How It's Accomplished: Reporting Federal Adjustments for Partnership Level Audits – Default Rule

▶ **For Tiered Partners**

- ▶ Within 90 days after the date of federal deadline for Tiered Partners the Tiered Partners shall:
 - ▶ Complete all the above reporting requirements; and
 - ▶ Make all payments

▶ **Large Partnerships**

- ▶ Upon request, Audited Partnership or Tiered Partner with over 10,000 Direct Partners can request an additional 60-day extension

▶ **State Partnership Representative**

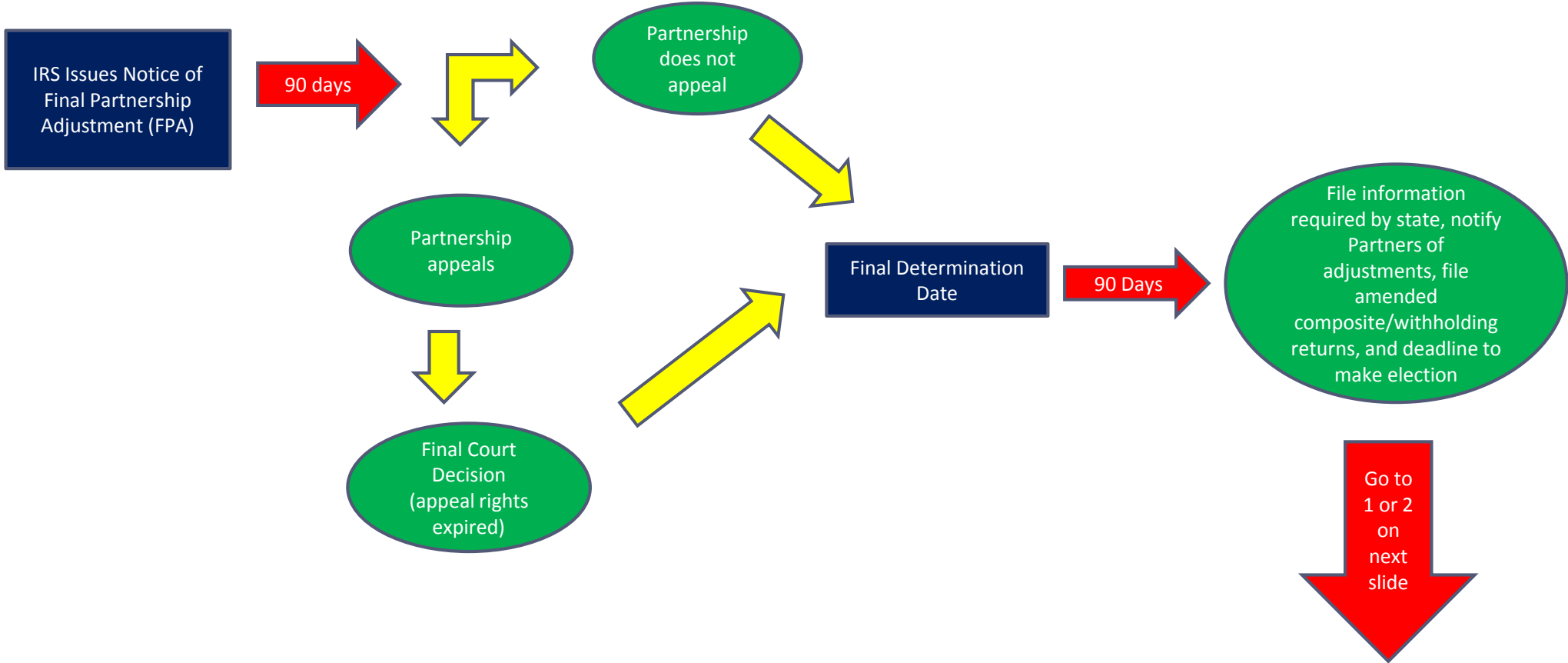
- ▶ By default, the state partnership representative is the federal representative, but following state revenue agency procedures, a different representative can be used for a state(s)

How It's Accomplished: Reporting Federal Adjustments for Partnership Level Audits – Election

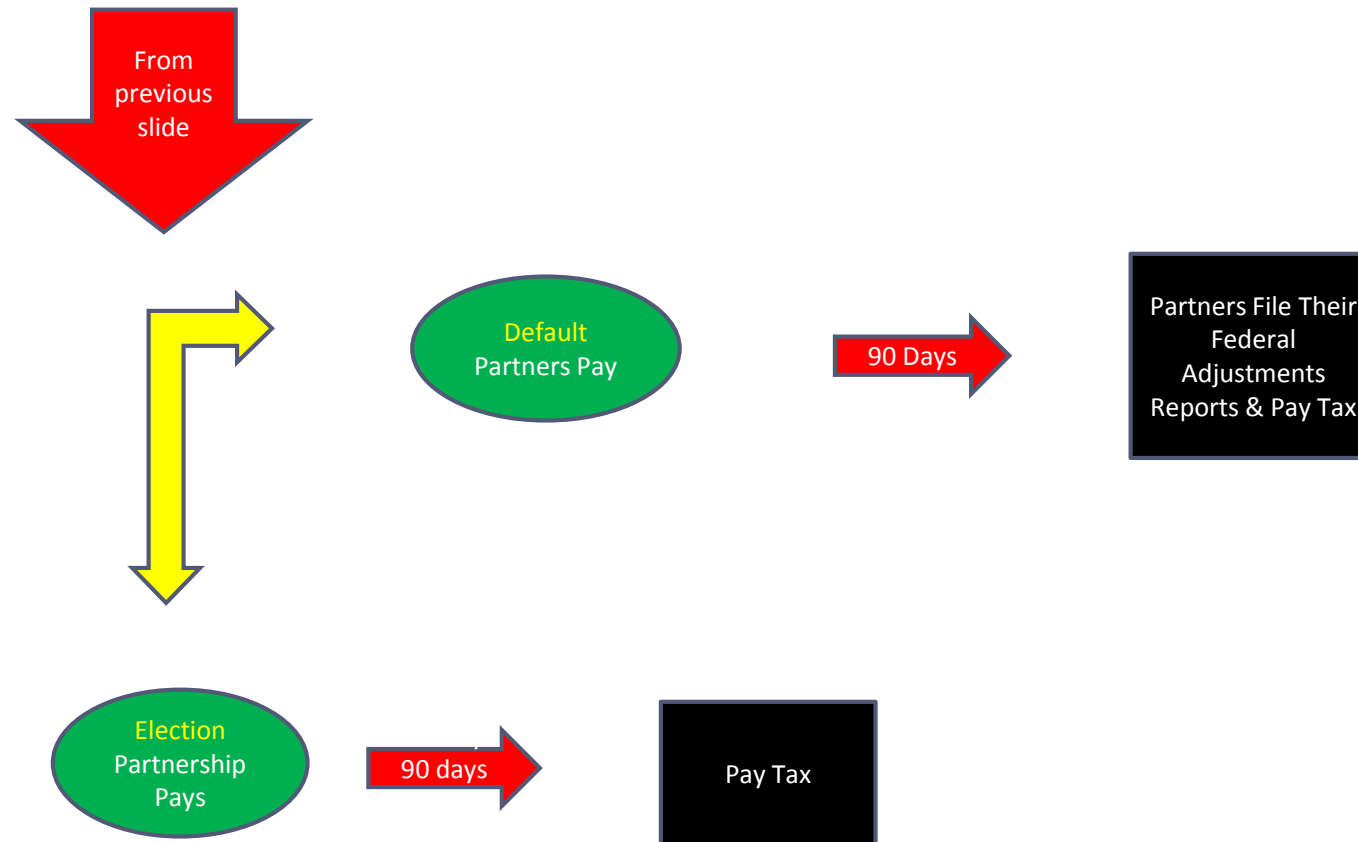
- ▶ Alternatively, Audited Partnership can make an election to pay the tax for Reviewed Years
- ▶ Within 90 days of Final Determination Date the Audited Partnership shall:
 - ▶ File a Federal Adjustments Report; and
 - ▶ Notify the state of the election
- ▶ Within 180 days of Final Determination Date, the Audited Partnership shall:
 - ▶ Pay tax for its Direct Partners based on calculation prescribed in Draft Model Statute
- ▶ Tiered Partners (and their Direct Partners) – Also eligible to make the election but are not subject to the interim time restrictions – they must finalize all elections, reporting, and payment of the tax within 90 days after the date of federal deadline
 - ▶ This applies to all Tiered Partners (including their Direct Partners)
 - ▶ Federal deadline is extended due date of the Audited Partnership's return for the adjustment year

Flow Chart following Federal Partnership Audit

Adjustment — Slide 1



Flow Chart following Federal Partnership Audit Adjustment – Slide 2



* For Composite Return Partners, Option 1 is used

Alternative Election by Mutual Agreement

- ▶ To address unique situations, the Model allows the Audited Partnership or Tiered Partners to enter into a mutual agreement with the State Revenue Agency
 - ▶ Can agree to use:
 - ▶ A different reporting method
 - ▶ A different payment method
 - ▶ Audited Partnership & Tiered Partners required to demonstrate requested method is reasonable

Comparison of Federal Process to Draft State Model

Federal Audit Reporting Process	Draft MTC State Model Process
Default – Partnership pays the tax using highest individual/corporate income tax rates	Default – Partnership notifies partners and partners pay the tax (composite/withholding filers still subject to partnership paying the tax)
Has option for partners to file amended returns to remit tax	Partnership can remit tax using partnership’s apportionment/allocation rules with tax paid using highest individual/corporate income tax rates
Has option for partnership to “push-out” tax to review year partners to remit the tax when they file their tax return for the year IRS completes the audit (adjustment year)	“Push-out” option requires reporting and payment on an amended return for original (“reviewed”) year. Ability to report/pay tax on current year tax return unavailable (likely an administrative systems issue w/most states)
Tiered Partners – must complete all filings by the extended due date of the Audited Partnership's return for the adjustment year	Subject to extension, Tiered Partners must complete all reporting and payments 90 days after the extended due date of the Audited Partnership's return for the adjustment year

► Questions?

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