

MTC Partnership/RAR Work Group
Notes from the September 17, 2020

I. Welcome and Introductions: Katie Lolley (Oregon), Chair

Katie noted that the work group was reconvened by the MTC uniformity committee after an issue was raised about how the model statute for reporting federal adjustments for partnerships treats adjustments that result in a tax refund.

II. Public Comment:

There was no public comment.

III. Developments to Consider:

A. Possible Changes to the Model –

Katie asked Helen Hecht, MTC, to go through the slides summarizing the federal process and the issue that was raised. (See Update on Federal Centralized Audit Process, Administrative Adjustment Requests, and the MTC Model Partnership/RAR Statute).

Helen noted, first, that there is a useful new IRS centralized audit and administrative adjustment report website which has information on centralized audit process, latest regs, other guidance, forms, etc.

Helen then reviewed the general process for federal partnership audits and administrative adjustment requests (AARs). She noted that the MTC model statute provisions were based on an assumption that adjustments that do not result in imputed underpayment (including IRC §6225(a)(2) adjustments, or “tax-negative” adjustments) would be allocated out and included in partner returns as other current-year tax items from the partnership in the adjustment year. For that reason, the model excludes these adjustments from the provisions of the model, generally, including from Subsection G which is the section that provides for refunds and credits.

But it now appears AAR tax-negative adjustments, and possibly similar audit adjustments, will be pushed out by the partnership, using that federal process. Under the push-out process, the partners will receive information to compute the overpaid tax in the reviewed (audit) year and that amount will then be taken as a nonrefundable federal tax credit on the adjustment year return.

Helen noted a couple additional points. First, the model attempts to leave related state provisions untouched (e.g. state statutes of limitations, apportionment rules, etc.). So

there was no intent to limit state tax refunds based on federal partnership adjustments to any greater extent than the state would limit refunds based on other types of federal adjustments.

Second, the drafters of the model all agreed that it would be very difficult for states to effectively copy the federal push-out approach, in part because there were other factors that states must take into account, including apportionment, residency, etc. So, instead, the model provides two alternatives—the partnership and partners must file amended returns (or alternatively, Federal Adjustment Reports), or the partnership may elect to pay any tax due.

Finally, Helen reviewed possible draft changes to the model language for discussion.

Katie then opened the floor for discussion.

- Nikki Dobay COST: Suggested that states consider a special procedure allowing partnerships to claim the state tax refund on behalf of the partners.
- A question was raised about how adjustments in intervening years would be treated. While the answer to that question was unclear, the group agreed that it should be considered.
- Dan DeYoung, KPMG: Asked the group to consider composite returns. Helen responded that the default rules under the model require filing amended returns in place of the original returns, reflecting the federal adjustments. So if a composite return was filed in the reviewed year, the model requires that the partnership amend and file that return. Helen also wondered whether it would help to have drafters notes that clarified that. Dan also suggested this might provide a means for paying a refund to the partnership (where a composite return was filed).
- Bruce Ely, Bradley Law: Asked Greg Bergman of Deloitte if he agreed with this approach.
- Greg Bergman, Deloitte: Yes, generally seems to address the problem.
- Donna in Indiana: Still talk about same partners whether for federal becomes something adjusted on 2021 return vs. on state if amend 2019 return, same partners regardless of year?
- A question was raised as to how states that tie to federal AGI would be affected by the model's approach. Helen responded that the model defines Federal Adjustment as a change in a federal tax item that would affect the state tax calculation. So if the change would affect federal AGI, and the state ties to that number, then the change would be a Federal Adjustment. It's just that the federal adjustment gets reported

differently in the federal push-out process. So states might have to look closely at the language in their statutes.

- Greg Bergman, Deloitte: Noted that states typically want to see the change made in an amended or adjusted 1120 or 1040, but under these federal push-out rules there won't be any federal return type information for states to tie to. Under the BBA push-out rules, adjustments are never going to hit the TPs taxable income or AGI in the reviewed year, but will be picked up in the later years in an offline calculation done on the returns.
- Rochelle Hodes, Crowe: Noted that IRS Form 8978 and 8986 effectively show the adjustments and require taxpayers to show their work on calculating the effect of the adjustment for federal purposes. Helen agreed this information would be useful to the states.

- B. Other Issues – None were raised. Katie noted that the next meeting would likely be in two weeks.

IV. Adjourn