



# TAX EXECUTIVES INSTITUTE, INC.

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September 11, 2018

Mr. Gregory Matson  
Executive Director  
Multistate Tax Commission  
444 North Capitol Street NW  
Washington, DC 20001-1538

## **RE: Model Uniform Statute and Regulation for Reporting Adjustments to Federal Taxable Income and Federal Partnership Items as of July 18, 2018**

Dear Mr. Matson:

As you are aware, the Multistate Tax Commission (MTC) formed the Partnership Project in Fall 2016 to address whether new state statutes are needed to address the Bipartisan Budget Act of 2015's (BBA) new federal centralized partnership audit regime, what states should do to audit and track partnership adjustments, whether withholding statutes are effective for multiple-tiered entities, and how old statutes intersect with entity-level federal liability.

Tax Executives Institute (TEI), along with stakeholders such as the American Bar Association's State and Local Tax Committee, the Council on State Taxation, the American Institute of CPAs, the Institute for Professionals in Taxation, and the Master Limited Partnership Association created a working group (Interested Parties) to participate in the MTC's Partnership Project and work on a model statute for reporting federal adjustments to the state. The Interested Parties recognize that consistency among state rules and ease of reporting are essential to efficiently implement the federal partnership audit rules at the state level.

With input from the Interested Parties and the states, the MTC's Partnership Project concluded its work in July 2018, culminating in the Model Uniform Statute and Regulation for Reporting Adjustments to Federal Taxable Income and Federal Partnership Items as of July 18, 2018 (Model Uniform Statute). The MTC's Uniformity Committee is presenting the Model Uniform Statute to the MTC's Executive Committee on September 12, 2018.

In conjunction with and in support of this effort, TEI updated its State and Local Tax Policy Statement Regarding State Implementation of the Federal

Partnership Audit Rules to reflect the principles contained in the Model Uniform Statute. TEI endorses these principles and supports states' adoption of the Model Uniform Statute as they seek to enact legislation implementing the federal partnership audit rules at the state level. A copy of TEI's updated policy statement is attached for your reference.

TEI welcomes the opportunity to work with the MTC and the states as they continue efforts on this important matter.

Respectfully submitted,

**Tax Executives Institute**



James P. Silvestri  
International President

cc: Helen Hecht, General Counsel, Multistate Tax Commission



# TAX EXECUTIVES INSTITUTE, INC.

## State and Local Tax Policy Statement Regarding State Implementation of the Federal Partnership Audit Rules

Tax Executives Institute maintains that consistency among state rules and ease of reporting are essential to efficiently implement the Bipartisan Budget Act of 2015's (BBA) federal partnership audit rules at the state level.

Partnerships subject to partnership-level audits under the BBA should have the right to appoint state partnership representative(s) that differ from the federal partnership representative and that vary by state.

Imputed underpayments and overpayments arising from partnership level audits should be allocated among the partners as specified in the partnership agreement in effect for the year subject to audit (reviewed year), using the reviewed year's apportionment data as adjusted by the federal audit.

Reporting partnership-level audit adjustments to states should not be triggered until a final determination, which should be deemed to occur after all adjustments made by the IRS to the federal taxable income of the partnership have become final and all appeal rights under the IRC are exhausted or have been waived for the partnership's taxable year. If the taxpayer was a member of a combined or consolidated group, the final determination triggering these reporting obligations should be after no adjustments remain to be finally determined for the entire group.

Subject to exceptions for partnerships subject to composite return/withholding obligations for non-resident direct partners and adjustments attributable to direct and indirect partners that are members of a unitary business, partnerships should have the option to (1) push adjustments out to their partners for their payment of state tax or (2) pay the state tax on the adjustments, in lieu of tax due from direct and indirect partners. This option shall be provided to partnerships regardless of how the partnership handled the payment of federal income tax on such adjustments.

### Background

In 2015, Congress passed the Bipartisan Budget Act of 2015 (BBA), which adopted a new federal centralized partnership audit regime for certain partnerships and became effective for taxable years beginning after December 31, 2017. Since the BBA's enactment, Congress passed a technical corrections bill and Treasury released proposed and final regulations providing taxpayers and the Internal Revenue Service (IRS) with further guidance regarding the new federal partnership audit rules.

The new federal partnership rules, which allow the IRS to audit and assess partnerships at the partnership level, have important implications for how partnerships and their partners report federal adjustments and pay taxes to the states. The Multistate Tax Commission (MTC) thus formed the Partnership Project in Fall 2016 to address whether new state statutes are needed, what states should do to audit and track partnership adjustments, whether withholding statutes are effective for multiple-tiered entities, and how old statutes intersect with entity-level federal liability.

TEI, along with stakeholders such as the American Bar Association's State and Local Tax Committee, the Council on State Taxation, the American Institute of CPAs, the Institute for Professionals in Taxation, and the Master Limited Partnership Association created a working group (Interested Parties) to participate in the MTC's Partnership Project, monitor proposed state legislation, and work on a model statute for reporting federal adjustments to the state. The Interested Parties recognize that consistency among state rules and ease of reporting are essential to efficiently implement the federal partnership audit rules at the state level.

With input from the Interested Parties and the states, the MTC's Partnership Project concluded its work in July 2018, culminating in the Model Uniform Statute and Regulation for Reporting Adjustments to Federal Taxable Income and Federal Partnership Items as of July 18, 2018 (Model Uniform Statute). The MTC's Uniformity Committee is presenting the Model Uniform Statute to the MTC's Executive Committee on September 12, 2018, at which time the MTC may open a formal public hearing to seek approval of the Model Uniform Statute. It is anticipated that states will look at the Model Uniform Statute as they consider state legislation addressing how to implement the federal partnership audit rules.

This policy statement summarizes the key principles of the Model Uniform Statute and confirms TEI's endorsement of the principles contained therein for taxpayers to report federal partnership adjustments to states.<sup>1</sup>

### **Summary of the BBA's Federal Partnership Audit Rules**

Under the BBA and subject to certain exceptions, the IRS will audit partnership items at the partnership level and issue a proposed adjustment to the partnership for the reviewed year. For 270 days, the reviewed year partners may file amended returns and pay their share of the tax (the pay-up method), and/or the partnership may submit modifications to the imputed underpayment. After that period, the IRS issues a notice of final partnership audit adjustment. The partnership then has 45 days to elect whether the partnership will use a push-out or partnership pays method. Under the push-out method, the partnership allocates the adjustments to the reviewed year partners and files an informational statement with the IRS, and the reviewed year partners pay the tax on their current year (adjustment year) returns. Under the partnership pays method, the partnership pays the tax on its adjustment year return, causing the current year partners to effectively bear the liability. These practices create complexity at the state level because partners and apportionment data may be different in the reviewed year and the adjustment year.

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<sup>1</sup> This policy statement updates TEI's June 2017 policy statement on this same topic. It also supplements TEI's January 2017 policy statement regarding the Reporting of Federal Income Tax Adjustments, which outlines TEI's position regarding the timing, triggers, and method for reporting federal adjustments to states generally, and identifies other provisions that would be useful to taxpayers and states.

The BBA also requires partnerships to designate a federal partnership representative who has sole authority to act on behalf the partnership with the IRS. The partnership and its partners are bound by the federal partnership representative's actions and decisions.

### Model Uniform Statute

The Model Uniform Statute adopts these key provisions for the reporting and payment of tax on final adjustments to the federal taxable income of partnerships and their partners:

- **State Partnership Representative:** The federal partnership representative shall serve as the state partnership representative unless the partnership designates another person as its state partnership representative. Such designations shall be made in writing. States may establish reasonable qualifications for state partnership representatives and reasonable procedures for making such designations. The partnership may designate different people as the state partnership representative for different states.
- **Calculation of Partners' Share of the Adjustments:** Each partner's share of under or over-reported taxable income shall be determined as specified in the partnership agreement in effect for the taxable year subject to audit. The share of the partnership's income apportionable to the state shall be based upon the reviewed year's apportionment data, as adjusted.
- **Final Determination Date:** The partnership's final determination shall occur when all adjustments made by the IRS to the federal taxable income of the partnership have become final and all appeal rights under the IRC are exhausted or have been waived for the partnership's taxable year. If the taxpayer was a member of a combined or consolidated group, the final determination triggering these reporting obligations shall be the first day on which no adjustments remain to be finally determined for the entire group.
- **Default Method of Reporting:** The state partnership representative shall be provided at least 90 days from the partnership's final determination date to (1) file a federal adjustments report with the state, (2) notify its direct partners of their distributive share of the adjustments, and (3) file amended composite and/or withholding returns for direct nonresident partners as required by state law and pay any additional state tax, interest, and penalties for such nonresident partners. Direct partners shall have at least 180 days from the partnership's final determination date to file a federal adjustments report reporting their distributive share of such adjustments and pay any additional state tax, interest, and penalties.
- **Partnership Pays Election:** The partnership alternatively may elect to pay the tax, interest, and penalties in lieu of such amounts its direct and indirect partners owe. Partnerships making this election shall have at least 90 days from the partnership's final determination date to (1) notify the state it is making the election and (2) file a federal adjustments report with the state. The partnership shall have at least 180 days from the partnership's final determination date to make the payment in lieu of amounts owed by

its direct and indirect partners. The partnership pays election shall not apply to portions of the federal adjustment that are includable in the unitary business income of any direct or indirect corporate partner or that result from an administrative adjustment request. Tax, interest, and penalties owed under this methodology shall be calculated as follows:

- **Direct Exempt Partners:** The distributive share of adjustments attributable to direct exempt partners not subject to tax on such income shall be excluded from the calculation.
- **Direct Corporate Partners and Direct Exempt Partners:** The distributive share of adjustments attributable to direct corporate partners and direct exempt partners subject to tax on such income (e.g., unrelated business income) shall be apportioned and allocated to the state using the state's existing multistate business activity apportionment and allocation laws/regulations and shall be subject to tax at the highest rate applicable to such entities.
- **Non-Resident Direct Partners:** The distributive share of adjustments attributable to non-resident direct partners subject to tax as individuals or trusts shall be sourced to the state using the state's existing non-resident partner sourcing laws/regulations and shall be subject to tax at the highest rate applicable to individuals and trusts.
- **Resident Direct Partners:** The distributive share of adjustments attributable to resident direct partners subject to tax as individuals or trusts shall be subject to tax at the highest rate applicable to individuals and trusts.
- **Tiered Partners:** The distributive share of adjustments attributable to tiered partners (partners that are pass-through entities themselves) shall be subject to tax according to the type of underlying income –
  - Income that would be sourced to the state if ultimately attributable to non-resident partners (e.g., business income) shall be sourced to the state using the sourcing rules attributable to such income;
  - Income that would be sourced to the state if attributable to non-resident partners (e.g., investment income) shall be sourced to the state and shall be subject to tax at the highest rate applicable to individuals and trusts, except to the extent the partnership can demonstrate the adjustment is attributable to non-resident indirect partners or partners not subject to tax on such income.
  - The partnership pays election shall be irrevocable unless the state taxing agency determines otherwise. Direct and indirect partners cannot claim deductions, credits, or refunds of amounts paid by the partnership to the state; however, resident direct partners may claim a credit for amounts paid by the partnership or tiered partner on the resident partner's behalf to another state.

- **Tiered Partners:** Tiered partners are subject to the above reporting and payment requirements and may use the default reporting method or the partnership pays election at each tier. Tiered partners and their partners must make all reports and payments within 90 days following the time for filing and furnishing statements to tiered partners under IRC section 6226. State taxing agencies may promulgate regulations to establish procedures and interim deadlines for reports and payments required by tiered partners and their partners.
- **Modified Reporting and Payment:** State taxing agencies and tiered partners may enter into agreements to use alternative reporting and payment methods if the partnership or tiered partner can demonstrate the requested method will reasonably provide for the reporting and payment of taxes, penalties, and interest due.
- **De Minimis Exceptions:** The state may promulgate regulations to establish a de minimis amount upon which taxpayers shall not be required to comply with the aforementioned reporting and payment obligations.

Approved: September 11, 2018