

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

*This draft was produced by a working group consisting of representatives of the Council On State Taxation (COST), Tax Executives Institute (TEI), the ABA Section of Taxation's SALT Committee, the American Institute of CPAs (AICPA), the Institute for Professionals in Taxation (IPT) and the Master Limited Partnership Association (MLPA) as well as a work group set up by the MTC uniformity committee. As of this date, this draft has not been officially endorsed by these organizations.*

This draft has been reformatted with line numbering as well as internal citations simplified and underlined to aid in the final review.

1    **SECTION A. Definitions**

2    The following definitions apply for the purposes of [this subdivision of the State Code]:

3           **(1) "Administrative Adjustment Request"** means an administrative adjustment request  
4    filed by a Partnership under IRC section 6227.

5           **(2) "Audited Partnership"** means a Partnership subject to a Partnership Level Audit result-  
6    ing in a Federal Adjustment.

7           **(3) "Corporate Partner"** means a Partner that is subject to tax under [reference to State law].

8           **(4) "Direct Partner"** means a Partner that holds an interest directly in a Partnership or Pass-  
9    Through Entity.

10          **(5) "Exempt Partner"** means a Partner that is exempt from taxation under [reference to State  
11    law] [except on Unrelated Business Taxable Income<sup>1</sup>].

12          **(6) "Federal Adjustment"** means a change to an item or amount determined under the In-  
13    ternal Revenue Code that is used by a Taxpayer to compute [State tax] owed whether that change  
14    results from action by the IRS, including a Partnership Level Audit, or the filing of an amended  
15    federal return, federal refund claim, or an Administrative Adjustment Request by the Taxpayer. A  
16    Federal Adjustment is positive to the extent that it increases state taxable income as determined  
17    under [reference to State laws] and is negative to the extent that it decreases state taxable income  
18    as determined under [reference to State laws].

19          **(7) "Federal Adjustments Report"** includes methods or forms required by [State Tax  
20    Agency] for use by a Taxpayer to report Final Federal Adjustments, including an amended [State]  
21    tax return, information return, or a uniform multistate report.

22          **(8) "Federal Partnership Representative"** means the person the Partnership designates  
23    for the taxable year as the Partnership's representative, or the person the IRS has appointed to act  
24    as the Federal Partnership Representative, pursuant to IRC section 6223(a).

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<sup>1</sup> Drafting note: This portion of definition should only be used by the [State] if it taxes unrelated business income.

1       **(9) “Final Determination Date”** means the following:

2           (a) Except as provided in Section A(9)(b) and (c), if the Federal Adjustment arises from  
3       an IRS audit or other action by the IRS, the Final Determination Date is the first day on which  
4       no Federal Adjustments arising from that audit or other action remain to be finally deter-  
5       mined, whether by IRS decision with respect to which all rights of appeal have been waived  
6       or exhausted, by agreement, or, if appealed or contested, by a final decision with respect to  
7       which all rights of appeal have been waived or exhausted. For agreements required to be  
8       signed by the IRS and the Taxpayer, the Final Determination Date is the date on which the  
9       last party signed the agreement.

10          (b) For Federal Adjustments arising from an IRS audit or other action by the IRS, if the  
11       Taxpayer filed as a member of a [combined/consolidated return/report under State law], the  
12       Final Determination Date means the first day on which no related Federal Adjustments aris-  
13       ing from that audit remain to be finally determined, as described in Section A(9)(a), for the  
14       entire group.

15          (c) If the Federal Adjustment results from filing an amended federal return, a federal re-  
16       fund claim, or an Administrative Adjustment Request, or if it is a Federal Adjustment reported  
17       on an amended federal return or other similar report filed pursuant to IRC section 6225 (c),  
18       the Final Determination Date means the day on which the amended return, refund claim, Ad-  
19       ministrative Adjustment Request, or other similar report was filed.

20       **(10) “Final Federal Adjustment”** means a Federal Adjustment after the Final Determination  
21       Date for that Federal Adjustment has passed.

22       **(11) “Indirect Partner”** means a Partner in a Partnership or Pass-Through Entity that itself  
23       holds an interest directly, or through another Indirect Partner, in a Partnership or Pass-Through  
24       Entity.

25       **(12) “IRC”** means the Internal Revenue Code of 1986, as codified at 26 United States Code  
26       (U.S.C.) Section 1, et seq., [insert State’s current practice to incorporate IRC] and applicable regu-  
27       lations as promulgated by the U.S. Department of the Treasury.<sup>2</sup>

28       **(13) “IRS”** means the Internal Revenue Service of the U.S. Department of the Treasury.

29       **(14) “Non-Resident Partner”** means an individual, trust, or estate Partner that is not a Resi-  
30       dent Partner.

31       **(15) “Partner”** means a person that holds an interest directly or indirectly in a Partnership  
32       or other Pass-Through Entity.

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<sup>2</sup> Drafting note: A State may need to address undefined terms. Suggested language – “To the extent terms used in this [arti-  
cle] are not defined in this Section or elsewhere in [citation to chapter in which this article is contained], it is the intent of the  
Legislature to conform as closely as possible to the terminology used in the amendments to the IRC pertaining to the compre-  
hensive partnership audit regime as contained in the Bipartisan Budget Act of 2015, Public Law 114-74, as amended, and this  
[article] shall be so interpreted.”

1           **(16) “Partnership”** means an entity subject to taxation under Subchapter K of the IRC.

2           **(17) “Partnership Level Audit”** means an examination by the IRS at the partnership level  
3 pursuant to Subchapter C of Title 26, Subtitle F, Chapter 63 of the IRC, as enacted by the Bipartisan  
4 Budget Act of 2015, Public Law 114-74, which results in Federal Adjustments.

5           **(18) “Pass-Through Entity”** means an entity, other than a Partnership, that is not subject to  
6 tax under [reference to State law imposing tax on C corporations or other taxable entities].

7           **(19) “Reallocation Adjustment”** means a Federal Adjustment resulting from a Partnership  
8 Level Audit or an Administrative Adjustment Request that changes the shares of one or more  
9 items of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive  
10 Reallocation Adjustment means the portion of a Reallocation Adjustment that would increase fed-  
11 eral income for one or more Direct Partners, and a negative Reallocation Adjustment means the  
12 portion of a Reallocation Adjustment that would decrease federal income for one or more Direct  
13 Partners [pursuant to Regulations under IRC section 6225].

14           **(20) “Resident Partner”** means an individual, trust, or estate Partner that is a resident in  
15 [State] under [reference to state laws] for the relevant tax period.

16           **(21) “Reviewed Year”** means the taxable year of a Partnership that is subject to a Partner-  
17 ship Level Audit from which Federal Adjustments arise.

18           **(22) “Taxpayer”** means [insert reference to State definition] and, unless the context clearly  
19 indicates otherwise, includes a Partnership subject to a Partnership Level Audit or a Partnership  
20 that has made an Administrative Adjustment Request, as well as a Tiered Partner of that Partner-  
21 ship.

22           **(23) “Tiered Partner”** means any Partner that is a Partnership or Pass-Through Entity.

23           **(24) “Unrelated Business Taxable Income”** has the same meaning as defined in IRC section  
24 512.<sup>3</sup>

## 25 **SECTION B. Reporting Adjustments to Federal Taxable Income – General Rule**

26 Except in the case of Final Federal Adjustments that are required to be reported by a Partnership  
27 and its Partners using the procedures in Section C, and Final Federal Adjustments required to be  
28 reported for federal purposes under IRC section 6225(a)(2), a Taxpayer shall report and pay any  
29 [State] tax due with respect to Final Federal Adjustments arising from an audit or other action by  
30 the IRS or reported by the Taxpayer on a timely filed amended federal income tax return, including  
31 a return or other similar report filed pursuant to IRC section 6225(c)(2), or federal claim for re-  
32 fund by filing a Federal Adjustments Report with the [State Tax Agency] for the Reviewed Year  
33 and, if applicable, paying the additional [State] tax owed by the Taxpayer no later than 180 days  
34 after the Final Determination Date.

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<sup>3</sup> Drafting note: This term should only be used by the [State] if it taxes unrelated business income.

1 **Section C. Reporting Federal Adjustments – Partnership Level Audit and Administrative Ad-**  
2 **justment Request**

3 Except for adjustments required to reported for federal purposes pursuant to IRC section  
4 6225(a)(2), and the distributive share of adjustments that have been reported as required under  
5 Section B, Partnerships and Partners shall report Final Federal Adjustments arising from a Part-  
6 nership Level Audit or an Administrative Adjustment Request and make payments as required un-  
7 der this Section C.

8 **(1) State Partnership Representative.**

9 (a) With respect to an action required or permitted to be taken by a Partnership under  
10 this Section C and a proceeding under [reference to provisions for State administrative appeal  
11 or judicial review] with respect to that action, the State Partnership Representative for the  
12 Reviewed Year shall have the sole authority to act on behalf of the Partnership, and the Part-  
13 nership’s Direct Partners and Indirect Partners shall be bound by those actions.

14 (b) The State Partnership Representative for the Reviewed Year is the Partnership’s Fed-  
15 eral Partnership Representative unless the Partnership designates in writing another person  
16 as its State Partnership Representative.

17 (c) The [State Tax Agency] may establish reasonable qualifications for and procedures for  
18 designating a person, other than the Federal Partnership Representative, to be the State Part-  
19 nership Representative.

20 **(2) Reporting and Payment Requirements for Partnerships Subject to a Final Federal**  
21 **Adjustment and their Direct Partners.** Final Federal Adjustments subject to the requirements  
22 of this Section C, except for those subject to a properly made election under Section C(3), shall be  
23 reported as follows:

24 (a) No later than 90 days after the Final Determination Date, the Partnership shall:

25 (i) File a completed Federal Adjustments Report, including information as required  
26 by [State Tax Agency regulation], with [State Tax Agency]; and

27 (ii) Notify each of its Direct Partners of their distributive share of the Final Federal  
28 Adjustments including information as required by the [State Tax Agency regulation]; and

29 (iii) File an amended composite return for Direct Partners as required under [refer-  
30 ence to State law] and/or an amended withholding return for Direct Partners as required  
31 under [reference to State law] and pay the additional amount under [reference to State  
32 law(s)] that would have been due had the Final Federal Adjustments been reported  
33 properly as required.

1 (b) [Except as provided under State law for minimal tax liabilities]<sup>4</sup>, no later than 180  
2 days after the Final Determination Date, each Direct Partner that is taxed under [reference to  
3 State law imposing tax on individuals, trusts, estates, C corporations, etc.] shall:

4 (i) File a Federal Adjustments Report reporting their distributive share of the ad-  
5 justments reported to them under Section C(2)(a)(ii) as required under [reference to  
6 State laws]; and

7 (ii) Pay any additional amount of tax due as if Final Federal Adjustments had been  
8 properly reported, plus any penalty and interest due under [reference to State law] and  
9 less any credit for related amounts paid or withheld and remitted on behalf of the Direct  
10 Partner under Section C(2)(a)(iii).

11 **(3) Election - Partnership Pays.** Subject to the limitations in Section C(3)(c), an Audited  
12 Partnership making an election under this Subsection (3) shall:

13 (a) No later than 90 days after the Final Determination Date, file a completed Federal  
14 Adjustments Report, including information as required by the [State Tax Agency rule or in-  
15 struction], and notify the [State Tax Agency] that it is making the election under this Subsec-  
16 tion (3);

17 (b) No later than 180 days after the Final Determination Date, pay an amount, deter-  
18 mined as follows, in lieu of taxes owed by its Direct and Indirect Partners:

19 (i) Exclude from Final Federal Adjustments the distributive share of these adjust-  
20 ments reported to a Direct Exempt Partner not subject to tax under [reference state law  
21 taxing certain income to tax-exempt entities].

22 (ii) For the total distributive shares of the remaining Final Federal Adjustments re-  
23 ported to Direct Corporate Partners subject to tax under [reference to State law] and to  
24 Direct Exempt Partners subject to tax under [reference state law taxing certain income  
25 to tax-exempt entities], apportion and allocate such adjustments as provided under [ref-  
26 erence to existing multi-state business activity allocation/apportion law or regulation]  
27 and multiply the resulting amount by the highest tax rate under [reference to State  
28 law(s)];

29 (iii) For the total distributive shares of the remaining Final Federal Adjustments re-  
30 ported to Non-Resident Direct Partners subject to tax under [reference to State law ap-  
31 plying to individuals and /or trusts], determine the amount of such adjustments which  
32 is [State]-source income under [reference to existing non-resident partner sourcing law  
33 or regulation], and multiply the resulting amount by the highest tax rate under

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<sup>4</sup> DRAFTER'S NOTE: If the state adopts a de minimis rule as further set out in this model, then this section would need to be conditioned on a reference to that rule.

1 [reference to State law applying to individuals and/or trusts];

2 (iv) For the total distributive shares of the remaining Final Federal Adjustments re-  
3 ported to Tiered Partners:

4 (A) Determine the amount of such adjustments which is of a type that it would  
5 be subject to sourcing to the [State] under [reference to existing State rules for allo-  
6 cating/apportioning income of non-resident partners]; and then determine the por-  
7 tion of this amount that would be sourced to the state applying [these rules];

8 (B) Determine the amount of such adjustments which is of a type that it would  
9 not be subject to sourcing to the [State] by a Nonresident Partner under [reference  
10 to existing State rules for income fully sourced based on a taxpayer's residency];

11 (C) Determine the portion of the amount determined in Section C(3)(b)(iv)(B)  
12 that can be established, under regulation issued by [State Agency], to be properly  
13 allocable to Nonresident Indirect Partners or other Partners not subject to tax on  
14 the adjustments; or that can be excluded under procedures for Modified Reporting  
15 and Payment Method allowed under Paragraph (5).

16 (v) Multiply the total of the amounts determined in Section C(3)(b)(iv)(A) and (B)  
17 reduced by the amount determined in Section C(3)(b)(iv)(C) by the highest tax rate un-  
18 der [reference to State law applying to individuals and/or trusts];

19 (vi) For the total distributive shares of the remaining Final Federal Adjustments re-  
20 ported to Resident Direct Partners subject to tax under [reference to State law applying  
21 to individuals and /or trusts], multiply that amount by the highest tax rate under [refer-  
22 ence to State law applying to individuals and/or trusts];

23 (vii) Add the amounts determined in Section C(3)(b)(ii), (iii), (v), and (vi), along  
24 with penalty and interest as provided in [reference to State law].

25 (c) Final Federal Adjustments subject to this election exclude:

26 DRAFTER'S NOTE: THE EXCLUSION IN (i) IS INTENDED TO ADDRESS THE PARTICULAR  
27 STATE'S LAW WITH RESPECT TO ADJUSTMENTS THAT WOULD FLOW THROUGH TO  
28 CORPORATE PARTNERS AND MIGHT BE TREATED AS PART OF THE UNITARY BUSI-  
29 NESS OF THE CORPORATION.

30 (i) The distributive share of Final Audit Adjustments that under [reference to State  
31 law] must be included in the unitary business income of any Direct or Indirect Corporate  
32 Partner, provided that the Audited Partnership can reasonably determine this; and

33 (ii) Any Final Federal Adjustments resulting from an Administrative Adjustment Re-  
34 quest.

35 (d) {OPTIONAL PROVISIONS}

36 Option A - An Audited Partnership not otherwise subject to any reporting or payment

1 obligation to [State] that makes an election under this Subsection (3) consents to be sub-  
2 ject to [State] laws related to reporting, assessment, payment, and collection of [State]  
3 tax calculated under the election.

4 Option B - An Audited Partnership not otherwise subject to any reporting or payment  
5 obligation to [State] may not make an election under this Subsection (3).

6 **(4) Tiered Partners.** The Direct and Indirect Partners of an Audited Partnership that are  
7 Tiered Partners, and all of the Partners of those Tiered Partners that are subject to tax under [ref-  
8 erence to State laws imposing tax on individuals, trusts, corporations, etc.] are subject to the re-  
9 porting and payment requirements of Section C(2) and the Tiered Partners are entitled to make  
10 the elections provided in Section C(3) and (5). The Tiered Partners or their Partners shall make  
11 required reports and payments no later than 90 days after the time for filing and furnishing state-  
12 ments to Tiered Partners and their Partners as established under IRC section 6226 and the reg-  
13 ulations thereunder. The [State Agency] may promulgate regulations to establish procedures and  
14 interim time periods for the reports and payments required by Tiered Partners and their Part-  
15 ners and for making the elections under this Section C.

16 **(5) Modified Reporting and Payment Method.** Under procedures adopted by and subject  
17 to the approval of the [State Agency], an Audited Partnership or Tiered Partner may enter into an  
18 agreement with the [State Agency] to utilize an alternative reporting and payment method, in-  
19 cluding applicable time requirements or any other provision of this Section C, if the Audited Part-  
20 nership or Tiered Partner demonstrates that the requested method will reasonably provide for  
21 the reporting and payment of taxes, penalties, and interest due under the provisions of this Section  
22 C. Application for approval of an alternative reporting and payment method must be made by the  
23 Audited Partnership or Tiered Partner within the time for election as provided in Section C(3) or  
24 (4), as appropriate.

25 **(6) Effect of Election by Audited Partnership or Tiered Partner and Payment of Amount**  
26 **Due.**

27 (a) The election made pursuant to Section C(3) or (5) is irrevocable, unless [State  
28 Agency], in its discretion, determines otherwise.

29 (b) If properly reported and paid by the Audited Partnership or Tiered Partner, the  
30 amount determined in Section C(3)(b), or similarly under an optional election under Section  
31 C(5), will be treated as paid in lieu of taxes owed by its Direct and Indirect Partners, to the  
32 extent applicable, on the same Final Federal Adjustments. The Direct Partners or Indirect  
33 Partners may not take any deduction or credit for this amount or claim a refund of the amount  
34 in this State. Nothing in this Subsection(C)(6) shall preclude a Direct Resident Partner from  
35 claiming a credit against taxes paid to this State pursuant to [reference to State law], any  
36 amounts paid by the Audited Partnership or Tiered Partner on the Resident Partner's behalf

1 to another state or local tax jurisdiction in accordance with the provisions of [State law or  
2 regulation allowing credit for taxes paid to another state or locality].

3 **(7) Failure of Audited Partnership or Tiered Partner to Report or Pay.** Nothing in this  
4 Section C prevents the [State Agency] from assessing Direct Partners or Indirect Partners for taxes  
5 they owe, using the best information available, in the event that a Partnership or Tiered Partner  
6 fails to timely make any report or payment required by this Section C for any reason.

7 **SECTION D. De Minimis Exception**

8 The [State Agency] at its discretion may promulgate regulations to establish a de minimis amount  
9 upon which a taxpayer shall not be required to comply with Sections B and C of this [Chapter].

10 **SECTION E. Assessments of Additional [State] Tax, Interest, and Penalties Arising from Ad-**  
11 **justments to Federal Taxable Income – Statute of Limitations**

12 The [State Agency] will assess additional tax, interest, and penalties arising from Final Federal  
13 Adjustments arising from an audit by the IRS, including a Partnership Level Audit, or reported by  
14 the Taxpayer on an amended federal income tax return or as part of an Administrative Adjustment  
15 Request by the following dates:

16 **(1) Timely Reported Federal Adjustments.** If a Taxpayer files with the [State Agency] a  
17 Federal Adjustments Report or an amended [State] tax return as required within the period spec-  
18 ified in Sections B or C, the [State Agency] may assess any amounts, including in-lieu-of amounts,  
19 taxes, interest, and penalties arising from those Federal Adjustments if [State Agency] issues a  
20 notice of the assessment to the Taxpayer no later than:

21 (a) The expiration of the limitations period specified in [citation to State statute setting  
22 forth normal limitations period]; or

23 (b) The expiration of the one (1) year period following the date of filing with the [State  
24 Agency] of the Federal Adjustments Report.

25 **(2) Untimely Reported Federal Adjustments.** If the Taxpayer fails to file the Federal Ad-  
26 justments Report within the period specified in Sections B or C, as appropriate, or the Federal  
27 Adjustments Report filed by the Taxpayer omits Final Federal Adjustments or understates the cor-  
28 rect amount of tax owed, the [State Agency] may assess amounts or additional amounts including  
29 in-lieu-of amounts, taxes, interest, and penalties arising from the Final Federal Adjustments, if it  
30 mails a notice of the assessment to the Taxpayer by a date which is the latest of the following:

31 (a) The expiration of the limitations period specified in [citation to State statute setting  
32 forth normal limitations period]; or

33 (b) The expiration of the one (1) year period following the date the Federal Adjustments  
34 Report was filed with [State Agency]; or

35 (c) Absent fraud, the expiration of the six (6) year period following the Final Determina-  
36 tion Date.



1 **SECTION F. Estimated [State] Tax Payments During the Course of a Federal Audit**

2 A Taxpayer may make estimated payments to the [State Agency], following the process prescribed  
3 by the [State Agency], of the [State] tax expected to result from a pending IRS audit, prior to the  
4 due date of the Federal Adjustments Report, without having to file the report with the [State  
5 Agency]. The estimated tax payments shall be credited against any tax liability ultimately found to  
6 be due to [State] (“Final [State] Tax Liability”) and will limit the accrual of further statutory inter-  
7 est on that amount. If the estimated tax payments exceed the final tax liability and statutory inter-  
8 est ultimately determined to be due, the Taxpayer is entitled to a refund or credit for the excess,  
9 provided the Taxpayer files a Federal Adjustments Report or claim for refund or credit of tax pur-  
10 suant to [citation to State statute setting forth claim for refund requirements] no later than one  
11 year following the Final Determination Date.

12 **SECTION G. Claims for Refund or Credits of Tax Arising from Final Federal Adjustments**  
13 **Made by the IRS**

14 Except for Final Federal Adjustments required to be reported for federal purposes under IRC sec-  
15 tion 6225(a)(2), a Taxpayer may file a claim for refund or credit of tax arising from Federal Ad-  
16 justments made by the IRS on or before the later of:

17 (1) The expiration of the last day for filing a claim for refund or credit of [State] tax pursuant  
18 to [citation to State statute setting forth claim for refund requirements], including any extensions;  
19 or

20 (2) One year from the date a Federal Adjustments Report prescribed in Sections B or C, as  
21 applicable, was due to the [State Agency], including any extensions pursuant to Section G.

22 The Federal Adjustments Report shall serve as the means for the Taxpayer to report additional  
23 tax due, report a claim for refund or credit of tax, and make other adjustments (including to its net  
24 operating losses) resulting from adjustments to the Taxpayer’s federal taxable income.

25 **SECTION H. Scope of Adjustments and Extensions of Time.**

26 (1) Unless otherwise agreed in writing by the Taxpayer and the [State Agency], any adjust-  
27 ments by the [State Agency] or by the Taxpayer made after the expiration of the [State’s normal  
28 statute of limitations for assessment and refund] is limited to changes to the Taxpayer’s tax liabil-  
29 ity arising from Federal Adjustments.

30 (2) The time periods provided for in [this subdivision of the State Code] may be extended:

31 (a) Automatically, upon written notice to [State agency], by 60 days for an Audited Part-  
32 nership or Tiered Partner which has [10,000] or more Direct Partners; or

33 (b) By written agreement between the Taxpayer and the [State Agency] [pursuant to  
34 any regulation issued under this Section].

35 (3) Any extension granted under this Section G for filing the Federal Adjustments Report ex-  
36 tends the last day prescribed by law for assessing any additional tax arising from the adjustments

1 to federal taxable income and the period for filing a claim for refund or credit of taxes pursuant to  
2 [citation to State statute setting forth claim for refund requirements].

3 **SECTION I. Effective Date**

4 The amendments to this [section/chapter] applies to any adjustments to a Taxpayer's federal tax-  
5 able income with a Final Determination Date occurring on and after [date].

## NOTES

Certain provisions of this model, particularly Section C, were drafted by the Commission's Uniformity Committee in anticipation of federal audits that will be done through the new centralized partnership audit regime beginning for 2018 tax years. These provisions are necessary because states otherwise lack the means to require reporting of, or to assess taxes related to, partnership audit adjustments where the federal tax is assessed to and paid by the partnership or is "pushed-out" to the partners in adjustment-year returns. This model also updates provisions of the Commission's 2003 Model Uniform Statute for Reporting Federal Tax Adjustments.

The drafters concluded that states could not effectively implement a "push-out" approach similar to the federal approach, for various reasons. But Section C does include a partnership-pays election for paying state taxes owed on federal partnership audit adjustments. In drafting the provisions of this election, it was recognized that, with respect to "tiered partners," the electing partnership may not have sufficient information to source the adjustments allocated to those partners—particularly information on the residency status of the tiered partner's individual partners ("indirect partners"). Therefore, if a federal audit adjustment relates to a type of income that is sourced 100% by the state based on residency (rather than apportioned), the calculation of the partnership-pays amount effectively assumes that indirect partners are residents so that 100% of the adjustment would be sourced to the state for those tiered partners. See Section C(3)(b)(iv)(B). Nor would the tiered partner's indirect partners be allowed a credit for taxes paid to another state. If the partnership wishes, instead, to apportion any part of these types of adjustments when allocated to tiered partners, it will have to provide information on the residency of the tiered partner's taxpaying partners. See Section C(3)(b)(iv)(C).

Throughout the model, references to existing state laws of the adopting state must be included. Particularly in the partnership pays election, there are references to state law governing the sourcing of multistate income (allocation and apportionment rules). The model does not

constrain the states in applying particular sourcing rules nor does it require the states to apply uniform rules. Those rules can also change over time. And, to the extent that there are specific rules for apportioning partnership income or certain types of income, those rules would apply in the partnership-pays election context. Such rules might also include equitable apportionment provisions. The only requirement is that the rules generally applicable in the reviewed year (audit year) be applied to adjustments for that year.

Note that certain provisions of the model specify that regulations should be promulgated to implement those provisions. Other regulations, or agency instructions, may be necessary, as well, to fully implement the model. The model was drafted in this manner, in part, to retain some flexibility, recognizing that the provisions related to partnership audit adjustments are new and untested. In addition to the provisions that specifically call for regulations, states may wish to consider regulations or instruction to:

- Define the precise information required to be provided in a federal adjustments report, generally, and specifically in the case of federal partnership adjustments that must be reported by the partnership under Section C(2).
- Specify the manner in which federal adjustments, and especially federal partnership adjustments, might need to be modified in order to conform to state tax laws (e.g. where an add-back statute might apply to an adjusted item or where that item has no impact at the state level) including how those modifications would be reported by the partnership.
- Specify the information that would be required for a partnership electing the partnership-pays approach to overcome the presumption that, in some cases, the indirect partners are residents, and the manner of requesting other adjustments in the partnership-pays approach. Section C(3)(b)(iv)(C) and Section C(5).

- Define how adjustments determined to be unitary business income of a corporate partner should be reported and treated by that partner where the partnership makes the partnership-pays election. Section C(3)(c).
- Determine the manner of allowing credits for taxes paid to other states by the partnership for its direct resident partners. Section C(6)(b).
- Specify the manner for making estimated payments as provided for in Section F during the course of a federal audit.

Finally, the partnership-pays election may potentially have revenue impacts. In some cases, the tax paid under that election to the state would be greater (primarily because of the use of the highest marginal rate to compute the tax). The revenue may also be greater if a partnership generates income that would ordinarily be sourced to the state of residence, and if that partnership has indirect partners. In that case, the indirect partners would be presumed to be resident partners for purposes of computing the partnership-pays amount unless the partnership provides information to demonstrate otherwise. In at least one case, however, the tax paid may be less. This is where the partnership generates income that would ordinarily be apportioned if earned by nonresidents. In that case, the partnership would apportion the share of the income that flows to indirect partners, even if some of those partners are residents (and would be entitled to a credit for taxes paid to another state, but not to apportioning their income).

During the drafting process, concerns were raised as to whether the partnership-pays election might be used to shift income or avoid state taxes. In particular, the concerns focused on federal partnership adjustments that would be allocated by the electing partnership to “tiered partners.” The model’s provisions to address indirect partners, Section C(3)(b)(iv), discussed above, along with state-specific sourcing rules and equitable apportionment authority, were determined to be sufficient to address these concerns. If a state lacked these other types of authority, however, it might consider adopting such authority for this

purpose. This, in turn, might influence the estimate of any revenue impacts.