

**ATTACHMENT B - MTC STAFF CHANGES AND EDITS – OCTOBER 25, 2017**

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

*Revised Draft (Version #3) Submitted for Consideration on September 27, 2017*

**SECTION A. Definitions**

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

(RECOMMENDED) Definitions Related to Partnerships and Partners as Used in [this Subdivision]; As used in the following definitions, the term “person” has the same meaning as in [reference to State Law], the term “entity” means any person that is not an individual, and the term “interest” means an ownership or beneficial interest in an entity.

**Comment [HH1]:** See Explanation of Revisions – Definitions.

- (a) “Partnership” – means an entity subject to taxation under Subchapter K of the IRC.
- (b) “Pass-Through Entity” – means an entity, other than a Partnership, that is not subject to tax under [reference to State Law imposing tax on C corporations or other taxable entities].
- (c) “Partner” – when used without any modifier, means a person that holds an interest directly in a Partnership or other Pass-Through Entity.
- (d) “Indirect Partner” – means a Partner in a Partnership or Pass-Through Entity that itself holds an interest directly, or through another Indirect Partner, in a Partnership or Pass-Through Entity.
- (e) “Exempt Partner” – means a Partner that is exempt from taxation under [reference to state law] except on Unrelated Business Taxable Income.
- (f) “Corporate Partner” means a Partner or Indirect Partner that is subject to tax under [reference to State Law].
- (g) “Resident Partner” means an individual Partner or Indirect Partner that has his or her domicile in or is a resident for tax purposes in [State].
- (h) “Composite Return Partner” means a Partner in a Partnership that was required to be included in a composite return pursuant to [reference to State Law] in the Reviewed Year or a Subsequent Affected Year.
- (i) “Withholding Partner” means a Partner in a Partnership that the Partnership was required to withhold tax pursuant to [reference to State Law] for the Reviewed Year or a Subsequent Affected Year.
- (j) “Tiered Partner” means an Indirect Partner that is a Partnership or Pass-Through Entity.

**Comment [HH2]:** Retained these definitions even though in the revised Sec. C they are not used in the section as rewritten.

**Comment [HH3]:** The draft intends to treat administrative adjustment requests the same as partnership level audits but this is not made as clear as it should be throughout, especially since such requests are sometimes referenced and sometimes not. So this term is defined and used throughout.

(RECOMMENDED) “Administrative Adjustment Request” means an administrative adjustment request filed by a Partnership under IRC section 6227.

**Comment [HH4]:** Definition of Partnership Level Audit includes this language already and so it is unnecessary here. See also the definition of Federal Adjustment.

- (1) “Amended State Schedule K-1” ~~shall mean includes~~ a form or method prescribed by [State Agency] that reports a ~~partner’s~~ Partner’s share of ~~adjustments~~ Federal Adjustments ~~to partnership related items, and reallocations of income, expenses, gains, and losses to that partner,~~ that arise directly, or indirectly

through a Tiered Partner from a Partnership Level Audit or an Administrative Adjustment Request.

~~(2) “Composite Return Partners” shall mean the partners in a Partnership that were included or required to be included on a [State] [composite or group income tax return] filed by the Partnership for the Reviewed Year.~~

(RECOMMENDED) “Federal Adjustment” and Final Federal Adjustment. A “Federal Adjustment” means a change to an item or amount required to be determined under the Internal Revenue Code that is used by a Taxpayer to compute state tax owed for the Reviewed Year or a Subsequent Affected Year whether that change results from action by the IRS, including a Partnership Level Audit, or the filing of an amended federal return, federal refund claim, or an Administrative Adjustment Request by the Taxpayer. A Final Federal Adjustment means a federal adjustment after the Final Determination Date for that change has passed. A Federal Adjustment is positive to the extent that it increases state taxable income as determined under [reference to State Law] and is negative to the extent that it decreases state taxable income as determined under [reference to State Law].

~~(3) “Federal Adjustments Report” shall mean (1) an amended [State] tax return, (2) the Multistate Tax Commission’s model report of federal audit adjustments,<sup>4</sup> or (3) any other method or form authorized by the [State Agency]. The Federal Adjustments Report shall contain information reasonably necessary to provide the [State Agency] with an understanding of all adjustments to the Taxpayer’s federal taxable income and their impact on the Taxpayer’s [State] tax liability. The Federal Adjustments Report shall constitute the Taxpayer’s method to report additional [State] tax due, request a refund or credit of [State] tax the Taxpayer previously paid, and report any other changes (including adjustments to net operating losses) resulting from adjustments to the Taxpayer’s federal taxable income. (RECOMMENDED) includes a method or form required by [State Agency] for use by a Taxpayer to report Federal Adjustments, including an amended [State] tax return or a uniform multistate report.~~

~~(4) “Federal Partnership Representative” shall mean the person the Partnership designates for the taxable year; as the Partnership’s representative, or the person the IRS has appointed to act as the Federal Partnership Representative, pursuant to IRC Section 6223(a).~~

~~(5) “Final Determination Date,” means the following:~~

~~(a) For adjustments to the federal taxable income of a Taxpayer arising from an audit by the IRS, the Final Determination Date shall be the date upon which all such adjustments have become final and all appeal rights under the IRC are exhausted or have been waived.~~

~~(b) In the case of a Taxpayer that is a member of a [State combined reporting group and/or State consolidated] group, the Final Determination Date shall be deemed to occur when all the adjustments to the federal taxable income of all members of the Taxpayer’s [State combined reporting group and/or State consolidated] group for the taxable year have become final, and all appeal rights under the IRC are exhausted or have been waived for each member of the group.~~

~~(c) For administrative adjustment requests filed under IRC section 6227 by a Partnership, the Final Determination Date shall be the date the Partnership filed the administrative adjustment request; all adjustments to partnership related items, and any reallocations of income, expenses, gains, and losses among partners, shall be treated as if they were the result of a Partnership Level Audit.~~

~~(d) For bilaterally signed agreements between the IRS and the Taxpayer, the Final Determination Date shall be the date on which the last party signed the agreement.~~

(RECOMMENDED)

**Comment [HH5]:** This is apparently what is meant by “indirectly”—a term that is otherwise ambiguous.

**Comment [HH6]:** See Definitions Related to Partnerships and Partners as Used in [this Subdivision] above.

**Comment [HH7]:** See Staff Report of October 25, 2017 – Other Issues – Changes to Definitions.

**Comment [HH8]:** The wording of this definition has several problems, most significantly, that it contains substantive provisions that should not be included in a definition and are unnecessary. It can therefore be simplified as recommended.

**Comment [HH9]:** This is necessary for situations where this will be the case.

**Comment [HH10]:** There were multiple issues with this definition including undefined terms and ambiguities, structural issues, etc. It can also be simplified. See substitute definition below.

**Comment [HH11]:** This circumstance has been included, but not the case where a taxpayer files a federal amended return or a refund claim. Presumably, these circumstances should be treated similarly.

<sup>4</sup> Drafting note: It is suggested that States create different forms for corporations and partnerships to report federal adjustments.

(a) Except as provided in paragraph (b), if the related Federal Adjustment arises from an IRS audit, the Final Determination Date is the first day on which no Federal Adjustments arising from that audit for the particular tax year under review remain to be finally determined, whether by agreement, or, if appealed or contested, by a final decision with respect to which all rights of appeal have been waived or exhausted. For agreements required to be signed by the IRS and the Taxpayer, the Final Determination Date is the date on which the last party signed the agreement.

(b) If the Taxpayer filed as a member of a [combined/consolidated return/report under State law], the Final Determination Date means the first day on which no related Federal Adjustments from that audit remain to be finally determined for the entire group.

(c) If the Federal Adjustment results from the filing of an amended federal return, a federal refund claim, or the filing by a Partnership of an Administrative Adjustment Request, the Final Determination Date means the day on which the amended return, refund claim, or Administrative Adjustment Request was filed.

\_\_\_\_\_(6) “**IRC**” shall mean the Internal Revenue Code of 1986, as codified at 26 United States Code (U.S.C.) Section 1, et seq., [insert State’s current practice to incorporate IRC] and any applicable regulations as promulgated by the U.S. Department of the Treasury.<sup>2</sup>

(7) “**IRS**” shall mean the Internal Revenue Service of the U.S. Department of the Treasury.

~~(8) “**Partnership**” shall mean partnership as defined in [XXX of the State Code].~~

(9) “**Partnership Level Audit**” shall mean an examination by the IRS at the partnership level pursuant to Subchapter C of Title 26, Subtitle F, Chapter 63 of the IRC for which the Partnership has not made a qualifying election out pursuant to IRC Section 6221(b) and which results in Federal Adjustments including Reallocation Adjustments and adjustments to partnership-related items or reallocations of income, expenses, gains, and losses among such partners for the Reviewed Year.

(10) “**Nonresident Partner**” shall mean an individual, estate of a deceased individual, or trust that was a partner in a Partnership subject to a Partnership Level Audit during the Reviewed Year and is not a Resident Partner, Composite Return Partner, or Withholding Partner.

(RECOMMENDED) “**Reallocation Adjustment**” means a Federal Adjustment, or Final Federal Adjustment, that changes the shares of items of partnership income, gain, loss, expense, or credit allocated to Partners. The term positive Reallocation Adjustment means Reallocation Adjustments that would increase state taxable income for Partners, and the term negative Reallocation Adjustment means Reallocation Adjustments that would decrease state taxable income for Partners.

(11) “**Resident Partner**” shall mean an individual, estate of a deceased individual, or trust that was a partner in a Partnership subject to a Partnership Level Audit and was a resident of [State] for income tax purposes during the Reviewed Year.

(12) “**Reviewed Year**” shall mean the taxable year of a Partnership that is subject to a Partnership Level Audit from which Federal Adjustments arise and which results in adjustments to partnership related items or any reallocations of income, expenses, gains, and losses among partners.

~~(13) “**State Imputed Underpayment**” shall mean the netting of all final adjustments to~~

**Comment [HH12]:** Unnecessary since there can be no partnership audit in that case.

**Comment [HH13]:** Don’t know what “such” refers to here.

**Comment [HH14]:** We should not limit this provision in this way since the adjustments could also affect Subsequent Affected Years.

**Comment [HH15]:** See Definitions Related to Partnerships and Partners as Used in [this Subdivision] above.

**Comment [HH16]:** Unnecessary – see definition of Reviewed Year which specifies that it is a year subject to Partnership Level Audit.

**Comment [HH17]:** See Staff Report of October 25, 2017 – Other Issues – Changes to Definitions.

**Comment [HH18]:** Unnecessary – see definition of Reviewed Year which specifies that it is a year subject to Partnership Level Audit.

**Comment [HH19]:** This tracks the word we use in other sections.

**Comment [HH20]:** Not necessary since this language is included in the definition of Partnership Level Audit.

**Comment [HH21]:** This is too substantive to be a simple definition and so raises the risk of introducing some conflict or ambiguity. The revised Sec. C below does not use this term. To the extent the term is necessary, it should be introduced as part of the substantive provisions in Sec. C.

<sup>2</sup> Drafting note: A State may need to address undefined terms. Suggested language – “To the extent terms used in this [article] 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 comprehensive 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.”

partnership related items at the entity level for the Reviewed Year (excluding any reallocations of income, expenses, gains, and losses among partners), apportioned and allocated to [State] at the entity level, and multiplied by the applicable [State] income tax rate(s) as set forth in subsection C(8)(b).

**Comment [HH22]:** See also See Staff Report of October 25, 2017 – Important Substantive Issues – Reallocation Adjustments.

(14) **“State Partnership Adjustment Information Report”** shall mean a form or method prescribed by [State Agency] that identifies the a Partnership’s direct pPartners, and each Ppartner’s share of adjustments to partnership related items, and any reallocations of income, expenses, gains, and losses among such partners, Federal Adjustments that arise directly, or indirectly through a Tiered Partner, from a Partnership Level Audit or as a result of an Administrative Adjustment Request.

**Comment [HH23]:** This term is likely to be confused with the Federal Adjustments Report which the partnership will also have to file so the name is revised here.

**Comment [HH24]:** Echoes language used in other places for a similar purpose.

(15) **“State Partnership Representative”** shall mean the person the Partnership designates to be the Partnership’s representative for [State] tax purposes for the Reviewed Year pursuant to subsection C(1) and shall be the Federal Partnership Representative in absence of such designation.

**Comment [HH25]:** Not necessary since it is included in the definition of Partnership Level Audit.

**Comment [HH26]:** This is apparently what we mean by “indirectly” which, by itself, is an ambiguous term.

(16) **“[State] tax”** shall mean the [applicable State (or local) tax levied at XXX of the State Code].

**Comment [HH27]:** The state partnership representative is conditioned on substantive qualifications and so should be defined in the context of the subsection in C which sets out those qualifications.

(RECOMMENDED) **“Subsequent Affected Year”** means a tax year subsequent to the Reviewed Year in which a Federal Adjustment arising from an audit of that Reviewed Year affects the [State] income tax owed by a Taxpayer.

**Comment [HH28]:** Will need this definition in order to clarify that a taxpayer has an obligation to report state tax owed in subsequent affected years and to specify how the liability for state tax is to be computed for partnership level adjustments.

(17) **“Taxpayer”** shall mean [insert reference to State definition] and, unless the context clearly indicates otherwise, includes a Partnership subject to a Partnership Level Audit or which has made an Administrative Adjustment Request as well as a Tiered Partner of that Partnership.

**Comment [HH29]:** This is a placeholder meant to indicate that all the provisions in Sec.’s D-H need to be checked for potential conflicts that might arise in treating both partnerships and their partners as “taxpayers.”

(18) **“Tiered Partner”** shall mean a partner that is itself a Partnership, S corporation, or other pass through entity and that has received an Amended State Schedule K-1 pursuant to subsection C(4), C(7)(b)(iv)(A), or C(7)(b)(v)(A).<sup>3</sup>

**Comment [HH30]:** Need this to make the provisions in Sec. C that apply to tiered partners work.

(19) **“Unrelated Business Taxable Income”** shall have has the same meaning as defined in IRC Section 512.<sup>4</sup>

**Comment [HH31]:** See Definitions Related to Partnerships and Partners as Used in [this Subdivision] above.

(2) **“Withholding Partners”** shall mean the partners in a Partnership for whom the Partnership withheld or was required to withhold [State] tax for the Reviewed Year.

**Comment [HH32]:** See Definitions Related to Partnerships and Partners as Used in [this Subdivision] above.

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

Except in the case of federal adjustments Final Federal Adjustments and reallocations resulting arising from a Partnership Level Audit or an administrative adjustment request Administrative Adjustment Request filed by a Partnership under IRC section 6227, which are required to be reported by a Partnership and its direct and indirect partners Partners and Indirect Partners using the procedures in Section C, a Taxpayer shall notify the [State Agency] of adjustments to its federal taxable income Federal Adjustments arising from an audit by the IRS or reported by the Taxpayer on a timely filed amended federal income tax return, including a return filed pursuant to IRC section 6225, or federal claim for refund as follows:

**Comment [HH33]:** Consistent with term used elsewhere.

**Comment [HH34]:** Now defined terms.

(1) **Reporting of Federal Adjustments.** Except as provided in subsection B(2), a Taxpayer shall file a Federal Adjustments Report with the [State Agency] for the Reviewed Year and any Subsequent Affected Year and, if applicable, pay the additional [State] tax owed by the Taxpayer within one hundred eighty (180) days following no later than 180 days after the earlier of: (a) the Final Determination Date, or (b) the date on which the Taxpayer filed an amended federal income tax return or federal claim for refund.

**Comment [HH35]:** Now a part of the definition of final determination date.

<sup>32</sup> As contemplated in the introduced but not enacted Tax Technical Corrections Act of 2016 (HR 6439), the provisions of which are expected to be enacted by Congress or adopted via regulation.

<sup>4</sup> Drafting note: This term should only be used by the [State] if it taxes unrelated business income.

**(2) De Minimis Exception.**

**Comment [HH36]:** DID NOT REVIEW.

(a) **Notice of De Minimis Adjustments.** In the event the adjustments to the Taxpayer's federal taxable income result in a [State] tax liability of less than \$250 (excluding penalties and interest) or a refund, the Taxpayer may, in lieu of filing a Federal Adjustments Report, notify the [State Agency] in writing or on a form prescribed by the [State Agency] that the federal adjustments are de minimis. The Taxpayer shall file ~~such that~~ notice with the [State Agency] ~~within one hundred eighty (180) days no later than 180 days~~ following the earlier of the Final Determination Date or the date on which the Taxpayer filed an amended federal income tax return or claim for refund with the IRS. The Taxpayer's notice shall contain information reasonably necessary to provide the [State Agency] with an understanding of the federal adjustments and their impact on the Taxpayer's [State] tax liability.

(b) **Option to Request a Federal Adjustments Report.** In the event the Taxpayer provides the [State Agency] with notice that the adjustments are de minimis pursuant to subsection B(2), the [State Agency] may nevertheless request, in writing, that the Taxpayer file a Federal Adjustments Report. The [State Agency] shall mail ~~such that~~ request to the Taxpayer ~~within ninety (90) days following no later than 90 days after~~ the date on which the Taxpayer filed the notice with the [State Agency].

(c) **Filing of Requested Federal Adjustments Report.** In the event the [State Agency] requests a Federal Adjustments Report within the time prescribed in subsection B(2)(b), the Taxpayer ~~shall have~~has ~~sixty (60)~~ days from the date the [State Agency's] request is mailed to the Taxpayer to file a Federal Adjustments Report with the [State Agency] and, if applicable, pay the additional [State] tax owed by the Taxpayer.

(d) **State Tax Liability.** [Option 1] If the Taxpayer reported that it would have owed the State a de minimis [State] tax liability or was entitled to a de minimis [State] tax refund, and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report within the time prescribed in subsection B(2)(b), the Taxpayer's notice that the adjustments are de minimis will be ~~deemed~~ accepted by the [State Agency], and no [State] tax shall be due or refunded. [Option 2] If the Taxpayer reported that it would have owed the State a de minimis [State] tax liability and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report within the time prescribed in subsection B(2)(b), the Taxpayer's notice that the adjustments are de minimis will be ~~deemed~~ accepted by the [State Agency] and the [State Agency] may assess and bill the Taxpayer the fixed sum of \$250, which ~~shall will~~ include ~~any~~ statutory interest and penalties.

(e) **Finality of De Minimis Adjustments.** Absent fraud, the Taxpayer ~~shall will~~ not be subject to additional assessment, nor ~~shall is~~ the Taxpayer permitted to file a claim for refund or credit of [State] taxes pursuant to [citation to State statute setting forth claim for refund requirements] based on de minimis adjustments to the Taxpayer's federal taxable income for the tax year reported pursuant to Section B(2)(a).

**~~SECTION C. Reporting Adjustments to Federal Taxable Income — Partnership Level Audits~~**

**Comment [HH37]:** This Section was rewritten. Comments below were retained to note some (although not all) of the issues identified in this section.

~~Partnerships and their direct and indirect partners shall use the procedures in this Section C to report adjustments to partnership related items, and any reallocations of income, expenses, gains, and losses among partners, that arise directly or indirectly from a Partnership Level Audit or an administrative adjustment request filed by a Partnership under IRC section 6227, as follows:~~

**Comment [HH38]:** This section must *impose* filing and payment requirements, not simply instruct taxpayers to use its provisions.

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

**Comment [HH39]:** Unnecessary since this language is included in the definition of the Partnership Level Audit

~~(a) The State Partnership Representative for the Reviewed Year shall be the Partnership's Federal Partnership Representative for the Reviewed Year unless the Partnership designates another person as its State Partnership Representative.~~

**Comment [HH40]:** It's not clear if including administrative adjustment requests in this way here necessarily means that it will also be included below where the provision references an audit, but not an administrative adjustment request.

~~(b) The designation of another person as the State Partnership Representative shall be made in the manner prescribed by the [State Agency] and shall be deemed accepted by the [State Agency] unless the [State Agency] has reasonable cause and mails notice of its disapproval within fifteen (15) days following the Partnership's mailing of such notice to the [State Agency].~~

**Comment [HH41]:** The state also needs the ability to impose qualifications and to reject a state representative if, at any time subsequent to the designation, the representative is found not to be qualified.

~~(c) The State Partnership Representative for the Reviewed Year shall have the sole authority to act on behalf of the Partnership with [State Agency].~~

**Comment [HH42]:** These are not sufficient and they are related and should be combined.

~~(d) The Partnership and its direct and indirect partners shall be bound by any actions taken under this Section C by the State Partnership Representative.~~

~~(2) **Filing of Federal Adjustments Report.** A Partnership subject to a Partnership Level Audit shall file, within sixty (60) days of the Final Determination Date, a Federal Adjustments Report that indicates all adjustments to partnership related items and any reallocations of income, expenses, gains, and losses among partners resulting from that Partnership Level Audit.~~

**Comment [HH43]:** This language is unnecessary since it is in the definition of Partnership Level Audit and could also be indicated more simply, as with the word "completed."

~~(3) **Election for State Imputed Underpayments.**~~

**Comment [HH44]:** There were a number of issues with this subsection and it was duplicative of information included elsewhere.

~~(a) **Partnership Election.** In the event adjustments to partnership related items arising directly or indirectly from a Partnership Level Audit result in a State Imputed Underpayment for the Partnership, the Partnership shall notify [State Agency] at the time the Federal Adjustments Report is filed of its election for the Partnership to:~~

**Comment [HH45]:** See definition of "State Imputed Underpayment above and Staff Report of October 25, 2017 – Important Substantive Issues – Reallocation Adjustments. Basically, if there is a reallocation adjustment, nothing in this subsection applies except the requirement to provide amended state schedule K-1s in (i).

~~(i) **Partnership Pays Election.** Pay the State Imputed Underpayment on behalf of its partners and mail an Amended State Schedule K-1 to all Reviewed Year partners subject to a reallocation of income, expense, gain, and loss; or~~

~~(ii) **Partners Pay General Election.** Remit [State] tax on behalf of all Composite Return Partners and Withholding Partners, and mail an Amended State Schedule K-1 to all Reviewed Year partners; or~~

~~(iii) **Partners Pay Based on Residency Status Election.** Remit [State] tax on behalf of all Composite Return Partners, Withholding Partners, and Nonresident Partners, and mail an Amended State Schedule K-1 to all Reviewed Year partners.~~

**Comment [HH46]:** This is unnecessary if the deemed election is simply made the default rule. However, the changes below reflect that a different default rule should apply—with an election similar to (i) in this paragraph (a) above.

~~(b) **Failure to Make Election.** In the event a Partnership fails to make an election pursuant to subsection C(3)(a), the Partnership shall be deemed to have made an election pursuant to subsection C(3)(a)(i).~~

**Comment [HH47]:** Not sure this provision makes sense given that if the entity is dissolved or insolvent, it can't be expected to report or pay anything. See the way in which failure to report or pay is treated below in the rewritten Section C.

~~(c) **Dissolution or Insolvency of Partnership.** Any Partnership, including a Tiered Partner, that has been dissolved or become insolvent before or during the prescribed reporting periods provided in subsection C shall be deemed to have made an election under subsection C(3)(a)(i).~~

**Comment [HH48]:** There were a number of issues with this subsection and it was duplicative of information included elsewhere, so its provisions have been incorporated into a substituted provision below.

~~(d) **Election Irrevocable.** The election made under subsection C(3)(a) is irrevocable unless the [State Agency], in its discretion, otherwise allows.~~

**Comment [HH49]:** So – a partnership that hasn't made an election (but is deemed to) and hasn't yet paid the amount of the state imputed underpayment (but will) can avoid filing amended State Schedule K-1's, assuming there are no reallocation adjustments. This is not a reasonable provision.

~~(4) **Mailing of Amended State Schedule K-1s.** A Partnership subject to a Partnership Level Audit shall, within ninety (90) days of the Final Determination Date, mail an Amended State Schedule K-1 to its Reviewed Year partners and file a copy of such report with [State Agency] unless: (a) the Partnership has made or been deemed to have made an election pursuant to subsection C(3)(a)(i), (b) the Partnership will pay the State Imputed Underpayment on behalf of its partners under subsection C(5)(a), and (c) the Partnership Level Audit did not result in any reallocations of income, expenses, gains, or losses among partners.~~

**Comment [HH50]:** Note – here and elsewhere this term is used to apply to the state imputed underpayment, or composite return payment, or withholding. But it may leave substantial uncertainty as to how such payments are treated for tax and other purposes.

~~(5) **Reporting and Payment of Tax by Partnership.**~~

**Comment [HH51]:** There were a number of issues with this subsection and it was duplicative of information included elsewhere, so its provisions have been incorporated into a substituted provision below.

~~(a) **Partnership Pays Election.** A Partnership subject to a Partnership Level Audit that has made~~

or been deemed to have made an election pursuant to subsection C(3)(a)(i) shall, within one hundred eighty (180) days of the Final Determination Date, file a State Partnership Adjustment Report with the [State Agency] and pay the additional [State] tax owed on behalf of its partners. The [State] tax owed by the Partnership shall be determined in accordance with the provisions of subsection C(8)(b).

(b) **Partners Pay General Election.** A Partnership subject to a Partnership Level Audit that has made or been deemed to have made an election pursuant to subsection C(3)(a)(ii) shall, within one hundred eighty (180) days of the Final Determination Date, file a State Partnership Adjustment Report with the [State Agency], pay the additional [State] tax owed by Composite Returns Partners, and withhold and remit the tax owed by Withholding Partners. The [State] tax paid on behalf of the Composite Return Partners and Withholding Partners shall be determined in accordance with the provisions of subsection C(8)(b).

(c) **Partners Pay Based on Residency Status Election.** A Partnership subject to a Partnership Level Audit making an election pursuant to subsection C(3)(a)(iii) shall, within one hundred eighty (180) days of the Final Determination Date, file a State Partnership Adjustment Report with the [State Agency], pay the additional [State] tax owed by Composite Returns Partners and Nonresident Partners, and withhold and remit the tax owed by Withholding Partners. The [State] tax paid on behalf of the Composite Return Partners, Withholding Partners, and Nonresident Partners shall be determined in accordance with the provisions of subsection C(8)(b).

(d) **No Refunds or Credits.** No partner shall file an amended [State] return or take any similar action to obtain a refund of the tax paid by the Partnership on the partner's behalf pursuant to subsection C(5)(a) and any such action shall be invalid.

(e) **Assessments of Tax.** If the Partnership fails to timely pay the tax owed pursuant to subsection C(5), the [State Agency] may assess the Reviewed Year partners for their share of tax due within one (1) year from the date the Partnership's Federal Adjustment Report was filed or due, whichever is later, pursuant to subsection C(2). The [State Agency]'s assessment shall be presumed correct unless the Reviewed Year partner provides information sufficient to rebut [State Agency]'s presumption of correctness.

#### (6) Reporting and Payment of Tax by Partners.

(a) **General Rule.** With the exception of partners that are Tiered Partners subject to subsection C(7) and partners for whom the Partnership has already remitted [State] tax pursuant to subsection C(5)(b) or subsection C(5)(e), a partner receiving an Amended State Schedule K-1 pursuant to subsection C(4) shall, within one hundred eighty (180) days of the Final Determination Date, file a Federal Adjustments Report with [State Agency] to report additional [State] tax owed or claim a refund of [State] tax due and, if applicable, pay such [State] tax owed. The additional [State] tax owed by such partners shall be determined in accordance with the provisions of subsection C(8)(e).

(b) **Credits and Refunds.** A Composite Return Partner or Withholding Partner may file its own amended [State] income tax return within one (1) year of the date its Amended State Schedule K-1 was mailed to such partner and shall be entitled to a credit or refund of [State] income tax paid or withheld on such partner's behalf.

#### (7) Tiered Partnership Provisions.

(a) **Filing of Federal Adjustments Report.** If a Tiered Partner receives an Amended State Schedule K-1 pursuant to subsection C(4) and the Partnership has not made a payment of [State] tax on the Tiered Partner's behalf pursuant to subsection C(5), the Tiered Partnership shall file a Federal Adjustments Report indicating the Tiered Partner's share of adjustments to partnership related items, and any reallocations of income, expenses, gains, and losses to the Tiered Partner, that arose indirectly from the Partnership Level Audit, within one hundred fifty (150) days from the Final Determination Date or within sixty (60) days of the date an Amended State Schedule K-1 was mailed to the Tiered Partner, whichever is later.

**Comment [HH52]:** Ambiguous for a number of reasons.

**Comment [HH53]:** See Staff Report of October 25, 2017 – Important Substantive Issues.

**Comment [HH54]:** See Staff Report of October 25, 2017 – Important Substantive Issues.

**Comment [HH55]:** The concept is fine but it appears to conflict with the idea that the state imputed underpayment is paid "on behalf" of the partners. Also, it would need to now be clarified that the partners do not owe additional tax beyond what the partnership has paid. Instead, it needs to be clear that the tax paid by the partnership is paid in lieu of the tax owed by the partners.

**Comment [HH56]:** This doesn't actually leave the agency much time between the time it is known that the partnership will not comply and the time when the period effectively runs out. And this is in the face of not having information from the partnership. Also, this appear to potentially conflict with Section D. and as a limitation on the period for assessment, it should also go in Section D.

**Comment [HH57]:** Not clear if this is intended to cover both composite return payments and withholding. Typically, withholding may still carry a return filing requirement. In any case, this is ambiguous.

**Comment [HH58]:** Typically "due" connotes a claim that has been approved.

**Comment [HH59]:** Given how Sec C(8)(c) works, this is clearly a substantive tax provision that must be reviewed by the states as appropriate or not. See also the Staff Report of October 25, 2017 – Important Substantive Issues – Reallocation Adjustments.

**Comment [HH60]:** In general, this provision was unclear.

**Comment [HH61]:** This is generally included in the term "federal adjustment report" so it's not clear why it is used here.

**Comment [HH62]:** This is obviously not unlimited but subject to substantive tax provisions – to determine whether the partner owes the tax paid or withheld on the partner's behalf. (See also other comments concerning the term "on behalf.")

**Comment [HH63]:** These provisions are exceptionally complex given their time periods and cross-references.

**Comment [HH64]:** Again – it's not clear when a tiered partner might receive an amended schedule K-1 and also have had the partnership make a payment on the tiered partner's behalf. Again, it's not clear what paid "on behalf" of means—whether it includes the state imputed underpayment or the composite return payment (assuming it would apply) or both. If the adjustment is a reallocation adjustment, then presumably the state imputed underpayment (which excludes such adjustments) would not cover the tax due—and that reallocation adjustment would also be the thing that would trigger an amended schedule K-1. However, C(8) appears to net out reallocation adjustments in determining composite return payments.

~~(b) **Application of Subsection C(3), C(4), C(5) and C(6).** Subject to the following exceptions, subsections C(3), C(4), C(5) and C(6) shall apply to Tiered Partners and their partners:~~

~~(i) **Election for State Imputed Underpayments.** Subject to subsection C(7)(b)(ii), a Tiered Partner shall make an election pursuant to subsection C(3) at the time the Federal Adjustments Report is filed pursuant to subsection C(7)(a).~~

~~(ii) **Limitation of Election for Tiered Partners.** A Tiered Partner shall be ineligible to make an election pursuant to subsection C(3)(a) and must pay the State Imputed Underpayment on behalf of its partners, as if the Tiered Partner made an election pursuant to subsection C(3)(a)(i), if the Tiered Partner received its Amended State Schedule K-1 on or after the extended due date of the audited Partnership's federal tax return for the year that includes the Final Determination Date.<sup>5</sup>~~

~~(iii) **Partnership Pays Election.** In the event the Tiered Partner makes an election or is deemed to have made an election pursuant to subsection C(3)(a)(i), the Tiered Partner shall file a State Partnership Adjustment Report with [State Agency] and pay the additional [State] tax owed on behalf of its partners within ninety (90) days from the date the Amended State Schedule K-1 was mailed to the Tiered Partner.~~

~~(iv) **Partners Pay General Election.** In the event the Tiered Partner makes an election or is deemed to have made an election pursuant to subsection C(3)(a)(ii), the Tiered Partner shall:~~

~~(A) Mail Amended State Schedule K-1s to its partners within ninety (90) days from the date the Amended State Schedule K-1 was mailed to the Tiered Partner, and~~

~~(B) File a State Partnership Adjustment Report with [State Agency], pay the additional [State] tax owed by Composite Return Partners, and withhold and remit the [State] tax owed by Withholding Partners, within ninety (90) days from the date the Amended State Schedule K-1 was mailed to the Tiered Partner. The additional [State] tax owed by such partners shall be determined in accordance with subsection C(8)(c).~~

~~(v) **Partners Pay Based on Residency Status Election.** In the event the Tiered Partner makes an election pursuant to subsection C(3)(a)(iii), the Tiered Partner shall:~~

~~(A) Mail Amended State Schedule K-1s to its partners within ninety (90) days from the date the Amended State Schedule K-1 was mailed to the Tiered Partner, and~~

~~(B) File a State Partnership Adjustment Report with [State Agency], pay the additional [State] tax owed by Composite Return Partners and Nonresident Partners, and withhold and remit the [State] tax owed by Withholding Partners, within ninety (90) days from the date the Amended State Schedule K-1 was mailed to the Tiered Partner. The additional [State] tax owed by such partners shall be determined in accordance with subsection C(8)(c).~~

~~(vi) **Reporting and Payment of Tax by Partners.**~~

~~(A) **General Rule.** With the exception of Tiered Partners subject to subsection C(7) and partners for whom the Partnership remitted tax pursuant to subsection C(7)(b)(iv)(B) or subsection C(7)(b)(v)(B), a partner of a Tiered Partner receiving an Amended State Schedule K-1 pursuant to subsection C(7)(b)(iv)(A) or C(7)(b)(v)(A) shall, within ninety (90) days from the date the Amended State Schedule K-1 was mailed to the~~

**Comment [HH65]:** See Staff Report of October 25, 2017 – General or Structural Issues – and the discussion of time periods.

<sup>5</sup> This date limitation is based upon the tiered partnership structure provisions contained in the introduced but not enacted Tax Technical Corrections Act of 2016 (HR 6439), the provisions of which are expected to be enacted by Congress or adopted via regulation.

partner, file a Federal Adjustments Report with [State Agency] to report additional [State] tax owed or claim a refund of [State] tax due and, if applicable, pay such [State] tax owed.

**(B) Multiple Tiers.** If a partner of a Tiered Partner is itself also a Tiered Partner, that partner shall comply with subsection C(7).

**(c) Requests for Extensions.** A Tiered Partner may request, in writing or on a form prescribed by [State Agency], an extension of the due date of the various schedules, reports and returns due under subsection C(7) for up to an additional sixty (60) days. Such requests shall automatically be granted unless: (i) the request was filed after the applicable due date under Section C, or (ii) [State Agency] denies the request based on stated grounds of alleged tax evasion or insolvency of the Tiered Partner and the denial is mailed to the Tiered Partner within ten (10) days after its extension request was filed. If [State Agency] timely denies the request, the Tiered Partner shall have seven (7) days in which to file the applicable schedule, report or return after the date of receipt of [State Agency's] denial.

**(8) Calculation of Tax.** Additional [State] tax owed and refunds of [State] tax due shall be calculated as follows for Partnerships and their partners:

**(a) Determination of Each Partner's Share.** Each partner's share of under or over reported [State] taxable income shall be determined as specified in the Partnership agreement in effect for the Reviewed Year, subject to any final reallocations among partners arising from the Partnership Level Audit.

**(b) Tax Paid or Withheld by Partnership.** The amount of tax paid or withheld by a Partnership pursuant to subsections C(5) or C(7)(b)(iii) shall be determined by:

**(i)** Netting all final adjustments to partnership related items at the Partnership level for the Reviewed Year;

**(ii)** Allocating and apportioning such amounts to [State] at the Partnership level using [State's] allocation and apportionment provisions in effect for the Reviewed Year as if the Partnership was the Taxpayer;

**(iii)** Determining each partner's share of the adjustments to [State] taxable income in accordance with subsection C(8)(a), and

**(iv)** Multiplying each partner's share of the adjustment by the following [State] income tax rates in effect for the Reviewed Year:

**(A)** Zero (0) percent for the shares of [tax exempt or nontaxable] partners, [with the exception of any portion attributable to Unrelated Business Taxable Income];<sup>6</sup>

**(B)** The highest [State] individual income tax rate for the shares of partners that are individuals, S corporations, trusts, estates of deceased partners, disregarded entities that are not wholly owned by C corporations, and entities treated as Partnerships; and

**(C)** The highest [State] corporate income tax rate for shares of partners that are C corporations, disregarded entities wholly owned by C corporations (including other entities taxed as such), and the portion of under reported [State] taxable income attributable to Unrelated Business Taxable Income of all [tax exempt or nontaxable] partners;

**(c) Tax Payable by Partner.** The amount of [State] tax owed by a partner shall be determined by netting the partner's share of final adjustments to partnership related items not paid by the Partnership pursuant to subsections C(5), C(7)(b)(iv)(B), and C(7)(b)(v)(B), adding or subtracting all final reallocations

**Comment [HH66]:** The time period may as well be expanded rather than providing for automatic extensions. See also the Staff Report of October 25, 2017 – General or Structural Issues – discussion of time periods.

**Comment [HH67]:** "Owed" is often a term of art meaning the amount has been assessed and not paid, after allowing for voluntary payment. It may not be appropriate here.

**Comment [HH68]:** Similar to "owed" above, a "refund . . . due" may be a term of art meaning that the refund must be paid by the state (after all steps necessary by the taxpayer have been taken, etc.). So this term is not appropriate here—since it contains no qualifiers.

**Comment [HH69]:** This "shortcut" is a problem because it assumes that "income" is allocated which it is not. Partnership items are allocated and may be allocated separately. So an item of capital gain may be allocated differently to the partners than items of ordinary income under the partnership agreement. Also, this doesn't take into account reallocation adjustments—where, by definition, the partnership agreement does not apply.

**Comment [HH70]:** Not sure what a "final reallocation" is.

**Comment [HH71]:** See Staff Report of October 25, 2017 – Important Structural Issues – Netting of Adjustments.

**Comment [HH72]:** Technically, the Partnership is a "Taxpayer."

**Comment [HH73]:** Here, the term "on behalf" of the partners is not used – but the general reference to C(5), which includes all elections, is ambiguous. Does this include the state imputed underpayment? Presumably it does – but how is the partner's share of that amount determined? The rules here are insufficient to determine that.

<sup>6</sup> Drafting note: the bracketed language should be deleted here and in (C) if the state does not tax unrelated business income.

of income, expenses, gains or losses to that partner, and determining the increase or decrease to the partner's [State] taxable income for the Reviewed Year.<sup>7</sup>

~~(d) **Special Allocations.** The [State Agency] shall promulgate reasonable rules or regulations as it deems necessary to address special allocations among or between the partners that are affected by the Partnership Level Audit.~~

~~(e) **Calculation of Interest and Penalties.** For purposes of this Section C, the imposition and calculation of any penalties and interest imposed on any underpayment of tax shall follow the rules applicable under [insert State specific language, referencing statute, regulations, etc.].~~

**Comment [HH74]:** It does not appear that this was meant to supplant the normal substantive rules for determining the tax owed for the year, but the idea of adding and subtracting all final reallocations is somewhat ambiguous.

**Comment [HH75]:** Not sure why this is here.

### **Section C. Reporting Federal Adjustments – Partnership Level Audit and Administrative Adjustment Request**

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

(a) With respect to an action required or permitted to be taken by a Partnership under this Section C and a proceeding under [reference to provisions for State administrative appeal or judicial review] with respect to Federal Adjustments arising from a Partnership Level Audit or an Administrative Adjustment Request, the State Partnership Representative for the Reviewed Year shall have the sole authority to act on behalf of the Partnership, and its Partners and Indirect Partners shall be bound by those actions.

(b) The State Partnership Representative for the Reviewed Year is the Partnership's Federal Partnership Representative unless the Partnership designates another person as its State Partnership Representative as provided in paragraph (c).

(c) The [State Agency] shall establish reasonable qualifications for a person, other than the Federal Partnership Representative, to be the State Partnership Representative and the designation of that person must be made in the manner prescribed by the [State Agency] and will be accepted by the [State Agency] unless the [State Agency] has reasonable cause and mails notice of its disapproval no later than 15 days following the Partnership's mailing of that notice to the [State Agency].

(d) If, at any time, the [State Agency] determines that the State Partnership Representative designated under paragraph (c) does not meet the qualifications established by the [State Agency], or if that person is otherwise not able to act for the Partnership, the Federal Partnership Representative for the Reviewed Year will be the State Partnership Representative unless the [State Agency], in its discretion, allows the Partnership to designate another person who meets the qualifications to be the State Partnership Representative.

**(2) Reporting and Payment Requirements for Partnerships and Tiered Partners.** Unless a Partnership or any Tiered Partner that would be required to receive an Amended Schedule K-1 under this subsection (2) makes the election in subsection (3), then, for all Final Adjustments arising from a Partnership Level Audit or an Administrative Adjustment Request for the Reviewed Year or a Subsequent Affected Year, the Partnership or Tiered Partner shall:

(a) No later than 90 days after the Final Determination Date, file a completed Federal Adjustment Report and a completed State Partnership Information Report; and

(b) No later than 180 days after the Final Determination Date:

(i) File an Amended State Schedule K-1 for each of its Partners reflecting the effects of

<sup>7</sup> Drafting note: Determine language necessary for partners to apply credit for tax paid to another state by the partner directly and/or by the Partnership on the partner's behalf.

Federal Adjustments on the Partner under [reference to State Law]; and

(ii) File an amended composite report under [reference to State Law] or an amended withholding report under [reference to State Law] and pay the additional amount due under [reference to State Law(s)] that would have been due had the Final Federal Adjustments been reported properly as required.

**(3) Election – Partnership or Tiered Partners Pay.** If a Partnership or a Tiered Partner that would receive an Amended Schedule K-1 under subsection (2) makes an election under this subsection, it shall:

(a) No later than 90 days after the Final Determination Date, file a completed Federal Adjustment Report and a completed State Partnership Information Report, and notify the [State Agency] that it is making the election under this subsection;

(b) No later than 180 days after the Final Determination Date, pay an amount, determined as follows, in lieu of taxes owed by its partners:

(i) Exclude from Final Federal Adjustments and any positive Reallocation Adjustments the distributive share of these adjustments made to an Exempt Partner that is not Unrelated Business Taxable Income;

(ii) Allocate and apportion all remaining Final Federal Adjustments and positive Reallocation Adjustments in subparagraph (i) under to [State] under [reference to State Law];

(iii) Determine the total distributive share of the allocated and apportioned Final Federal Adjustments and positive Reallocation Adjustments determined in subparagraph (ii) that are allocated to Corporate Partners or Exempt Partners subject to tax under [reference to State Law]; the total distributive share allocated to Partners subject to tax under [reference to State Law applying to individuals and/or trusts];

(iv) For the total distributive shares of net Final Federal Adjustments plus positive Reallocation Adjustments allocated to Corporate Partners as determined in subparagraph (iii), multiply the total by the highest tax rate under [reference to State Law];

(v) For the total distributive shares of net Final Federal Adjustments plus positive Reallocation Adjustments allocated to Partners subject to tax under [reference to State Law applying to individuals and /or trusts] as determined in subparagraph (iii), multiply the total by the highest tax rate under [reference to State Law];

(vi) Add to the amount determined in subparagraph (iv) to the amount determined in subparagraph (v).

**(4) Reporting and Payment Requirements for Partners.**

Each Partner that is taxed under [reference to State Law taxing individuals and others] and each Corporate Partner shall, no later than 90 days after the receipt of an Amended State Schedule K-1:

(a) File an Federal Adjustment Report reporting the adjustments reflected on that Amended State Schedule K-1 as required under [reference to State Laws] ;

(b) Pay any additional amount of tax due as if the Final Federal Adjustment had been properly reported, including any penalty and interest due under [reference to State Law] and any credit for related amounts paid or withheld and remitted on behalf of the Partner by the Partnership or Pass-Through Entity under subparagraph (b)(ii) of subsection (2).

**(5) Optional Election.** The [State Agency], by administrative regulation, may, upon application by a

**Comment [HH76]:** Note – under this election, the partnership no longer has to file amended schedule K-1s or file amended composite returns or withholding.

Partnership or Tiered Partner submitted either prior to or no later than 30 days after the Final Determination Date, allow the use of some combination of the reporting and payment requirements of subsection (2) and subsection (3), if the Partnership or Tiered Partner adequately demonstrates that the requested method will reasonably provide for the reporting and payment of taxes, penalties, and interest owed.

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

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

(b) If properly reported and paid by the Partnership or Tiered Partner, the amount determined in paragraph (b) of subsection (3), or similarly under an optional election, will be treated as paid in lieu of taxes owed by its Partners on the same Federal Adjustments, but in no case may the Partners or Indirect Partners take any deduction or credit for this amount or claim a refund of the amount.

**(7) Failure of Partnership or Tiered Partner to Report or Pay.** Nothing in this Section C is intended to prevent the [State Agency] from assessing Partners or Indirect Partners for taxes they owe in the event that, for any reason, a Partnership or Tiered Partner fails to timely make any report or payment required by this Section.

**Comment [HH77]:** See also Section D below which addresses the SOL.

**SECTION D. Assessments of Additional [State] Tax, Interest, and Penalties Arising from Adjustments to Federal Taxable Income – Statute of Limitations**

The [State Agency] ~~shall be required to issue any assessment of~~ will assess additional [State] tax, interest, and penalties arising ~~directly~~ from ~~adjustments to a Taxpayer’s federal taxable income resulting Federal Adjustments arising~~ from an audit by the IRS, ~~including a Partnership Level Audit,~~ or reported by the Taxpayer on an amended federal income tax return ~~or as part of an Administrative Adjustment Request as follows by the following dates:~~

**Comment [HH78]:** This is really what this section covers.

(1) **Timely Reported Federal Adjustments.** If ~~the a~~ Taxpayer files with the [State Agency] a Federal Adjustments Report or an amended [State] tax return ~~as required~~ within the period specified in Section B or Section C, ~~as appropriate, reporting all Federal Adjustments,~~ the [State Agency] may assess any ~~additional~~ [State] ~~amounts including in-lieu-of amounts, taxes, interest, and penalties–~~ arising ~~directly~~ from ~~the adjustments to the Taxpayer’s federal taxable income, those Federal Adjustments provided that~~ if [State Agency] issues a notice of ~~such the~~ assessment to the Taxpayer ~~within the later of~~ no later than:

**Comment [HH79]:** In other places, we use the term “directly or indirectly” to indicate that the tax may be owed by partners of Tiered Partners. Here the use of the term “directly” could be confusing, therefore, and it is also unnecessary.

**Comment [HH80]:** Consistent with language used elsewhere.

**Comment [HH81]:** Simplification.

**Comment [HH82]:** To ensure that the report must contain information on all Federal Adjustments (see new defined term in definitions above).

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

**Comment [HH83]:** In other places, we use the term “directly or indirectly” to indicate that the tax may be owed by partners of Tiered Partners. Here the use of the term “directly” could be confusing, therefore, and it is also unnecessary.

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

(2) **Untimely Reported Federal Adjustments.** If the Taxpayer fails to file the Federal Adjustments Report within the period specified in Section B or Section C, as appropriate, or the Federal Adjustments Report filed by the Taxpayer omits Federal Adjustments or understates the correct amount of [State] tax owed, the [State Agency] may assess ~~any additional [State] amounts or additional amounts including in-lieu-of amounts,~~ taxes, interest, and penalties arising ~~directly~~ from the ~~adjustments to the Taxpayer’s federal taxable income~~ Federal Adjustments, provided that if it mails a notice of ~~such the~~ assessment to the Taxpayer ~~within the later of by a date which is the latest of the following:~~

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

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

~~(e)The expiration of the one (1) year period following the date on which the IRS, another state, or an organization representing and/or conducting audits for two or more states' tax agencies, notified the [State Agency], in writing or by electronic means, that the IRS made an adjustment with respect to the Taxpayer's federal taxable income for the taxable year; or~~

**Comment [HH84]:** This is likely to be unworkable.

(d) Absent fraud, the expiration of the six (6) year period following the Final Determination Date.

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

A Taxpayer may make estimated payments to the [State Agency] of the [State] tax that it determines may ultimately be owed to [State] as a result of a pending IRS audit, prior to the due date of the Federal Adjustments Report, without having to file ~~such the a~~-report with the [State Agency]. The estimated [State] tax payments ~~shall be is~~ credited against any tax liability ultimately found to be due to [State] ("Final [State] Tax Liability") and ~~shall will~~ limit the accrual of further statutory interest on that amount. If the estimated [State] tax payments exceed the final [State] tax liability and statutory interest ultimately determined to be due on that amount, or the IRS ultimately does not make any adverse adjustments to the Taxpayer's federal taxable income, the Taxpayer ~~shall be is~~ entitled to a refund or credit for the excess, provided the Taxpayer files with [State Agency] a Federal Adjustments Report or claim for refund or credit of [State] tax pursuant to [citation to State statute setting forth claim for refund requirements] ~~within one (1) no later than 1~~ year following the Final Determination Date.

#### **SECTION F. Claims for Refund or Credits of [State] Tax Arising from Federal**

##### **Adjustments Made by the IRS**

Notwithstanding the reporting requirement contained in Sections B or C, a Taxpayer may file a claim for refund or credit of [State] tax arising directly or indirectly from ~~federal adjustments~~Federal Adjustments made by the IRS on or before the later of: (1) the expiration of the last day for filing a claim for refund or credit of [State] tax pursuant to [citation to State statute setting forth claim for refund requirements], including any extensions; or (2) one (1) year from the date a Federal Adjustments Report prescribed in Sections B or C, as applicable, was due to the [State Agency], including any extensions pursuant to Section G.

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

#### **SECTION G. Scope of Adjustments and Extensions of Time.**

(1) Unless otherwise agreed in writing by the Taxpayer and the [State Agency], any adjustments by the [State Agency] or by the Taxpayer made after the expiration of the [State's normal statute of limitations for assessment and refund] ~~shall be is~~ limited to changes to the Taxpayer's [State] tax liability arising directly from ~~adjustments made by the IRS to the Taxpayer's federal taxable income for that tax year~~Federal Adjustments.

(2) The time periods provided for in [this subdivision of the State Code] may be extended by written agreement between the Taxpayer and the [State Agency] pursuant to any regulation issued under this section. Any extension granted under this Section G for filing the Federal Adjustments Report ~~shall~~-extends the last day prescribed by law for assessing any additional [State] tax arising from the adjustments to federal taxable income and the period for filing a claim for refund or credit of [State] taxes pursuant to [citation to

State statute setting forth claim for refund requirements].

**SECTION H. Effective Date**

The amendments to this [section/chapter] ~~shall~~ applies to any adjustments to a Taxpayer's federal taxable income with a Final Determination Date occurring on and after X [date].

#### Optional Model Regulation or Inclusion in Model Statute

Comment [HH85]: Not reviewed in detail.

(1) For purposes of determining ~~when~~ the “Final Determination Date” ~~has occurred~~, all adjustments to the Taxpayer’s federal taxable income must be final, and all appeal rights under the IRC are exhausted, for the Taxpayer’s federal taxable year.

(2) In the case of a Taxpayer that is a member of a [State combined reporting group and/or a State consolidated group], the Final Determination Date is ~~when~~ the date on which the federal taxable income for all members of the Taxpayer’s group have become final and all appeal rights under the IRC are exhausted for any member of the group’s federal taxable year.

Comment [HH86]: Not sure exactly what this means.

(3) The Final Determination Date shall be the date on which one of the following occurs: (a) The Taxpayer: (i) has final adjustments to its federal taxable income resulting from an examination by the IRS pursuant to Section 7601 of the IRC, including any requisite review by the Joint Committee on Taxation pursuant to Section 6405 of the IRC; and (ii) has not filed a petition for redetermination with the United States Tax Court pursuant to Sections 6213 or 6234 of the IRC or a claim for refund with a district court or the United States Court of Federal Claims pursuant to Sections 6234 or 7422 of the IRC, and the time for the Taxpayer to timely file ~~such a~~the petition for redetermination or ~~such a~~ claim for refund has lapsed under the applicable statute.

*Example 1: The Taxpayer is audited on a depreciation issue and an issue with the accrual of some gross income, both of which will require the Taxpayer’s state tax returns to be adjusted. The depreciation issue resulting in a \$500,000 federal income tax refund is resolved May 20, 2019 with a signed Form 870-AD; however, the accrual of gross income issue, resulting in a \$2.5 million tax deficiency, is not finalized by the IRS until June 30, 2020. The Taxpayer is not sure if it will file an appeal to the Tax Court; however, it ultimately does not file. The Final Determination Date is 90 days from June 30, 2020, when the Taxpayer was last able to timely file an appeal. The Taxpayer only has to report the \$2 million net tax deficiency for both issues.*

(b) The Taxpayer and the IRS have executed the forms necessary for the relevant tax period so as to establish finality under Section 7121(b) of the IRC.

*Example 2: The Taxpayer and the IRS have multiple audit issues for taxable year 2018 and they decide to resolve their issues by entering into a bilateral settlement agreement using a Form 870-AD on November 10, 2020. The Taxpayer signs the settlement on November 11, 2020, and the IRS signs it on November 15, 2020. The Final Determination Date is November 15, 2020.*

(c) The time for the IRS to make an assessment for the relevant tax period has expired pursuant to Section 6501 of the IRC.

*Example 3: The Taxpayer files an amended return with the IRS for taxable year 2018 that was timely filed with the IRS on March 15, 2019. The amended return, reporting \$1 million in additional income, was received by the IRS on February 28, 2022. The IRS has 60 days to assess the Taxpayer for additional tax because the return was filed ~~within 60 days of~~ no later than 60 days after the expiration of the three-year statute of limitations. The IRS takes no additional action; therefore, the Final Determination Date is 60 days from the date IRS received the amended return on February 28, 2022.*

or

(d) A judgment from a United States court, or any other court of original jurisdiction to which the

United States has submitted to personal jurisdiction regarding a Taxpayer's tax issues, has become final under Section 2412(d)(2)(G) of Title 28 of the United States Code.

**Example 4:** Same facts as example 1, except the Taxpayer timely pays the \$2 million in tax and files for a refund and sues in federal district court. On July 10, 2021, the Taxpayer receives a ruling from the court denying the refund in full. The Taxpayer timely files an appeal with a federal circuit court of appeals and on August 15, 2022 the Taxpayer receives a final order which allows it to deduct \$1 million more of the IRS assessed tax on the accrual of income. Neither the Taxpayer nor the IRS appeals to the U.S. Supreme Court. The Final Determination Date is 90 days from August 15,

2022, the last day a writ of certiorari, without an extension, could timely be filed.

(a) With respect to Partnerships that have undergone a Partnership Level Audit, the latter of (i) the close of the 90th day after the day on which a notice of a final partnership adjustment was mailed, and (ii) if a petition is filed under IRC Section 6234 with respect to ~~sueh~~-the notice, the decision of the court has become final.

**Example 5:** Partnership's Federal Partnership Representative agrees with IRS changes after the audit is concluded. The Final Determination Date for the Partnership is 90 days from the date the IRS mailed the final partnership adjustment.