



Multistate Tax Commission

Fall Uniformity Meetings

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Federal Entity-Level Partnership

Auditing and Assessment: Ready?

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*(slides 3-7 prepared by Joe Milack, Fast Enterprises (used by permission))

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H.R. 1314, the Bipartisan Budget Act of 2015, Section 1001, et seq.

In response to congressional concern that partnership income was escaping effective audit coverage, the IRC 's 1982 TEFRA provisions have been completely changed.

Entity Level Partnership Audit and Assessment Effective for Tax Years Beginning 1/1/2018 (or much sooner).

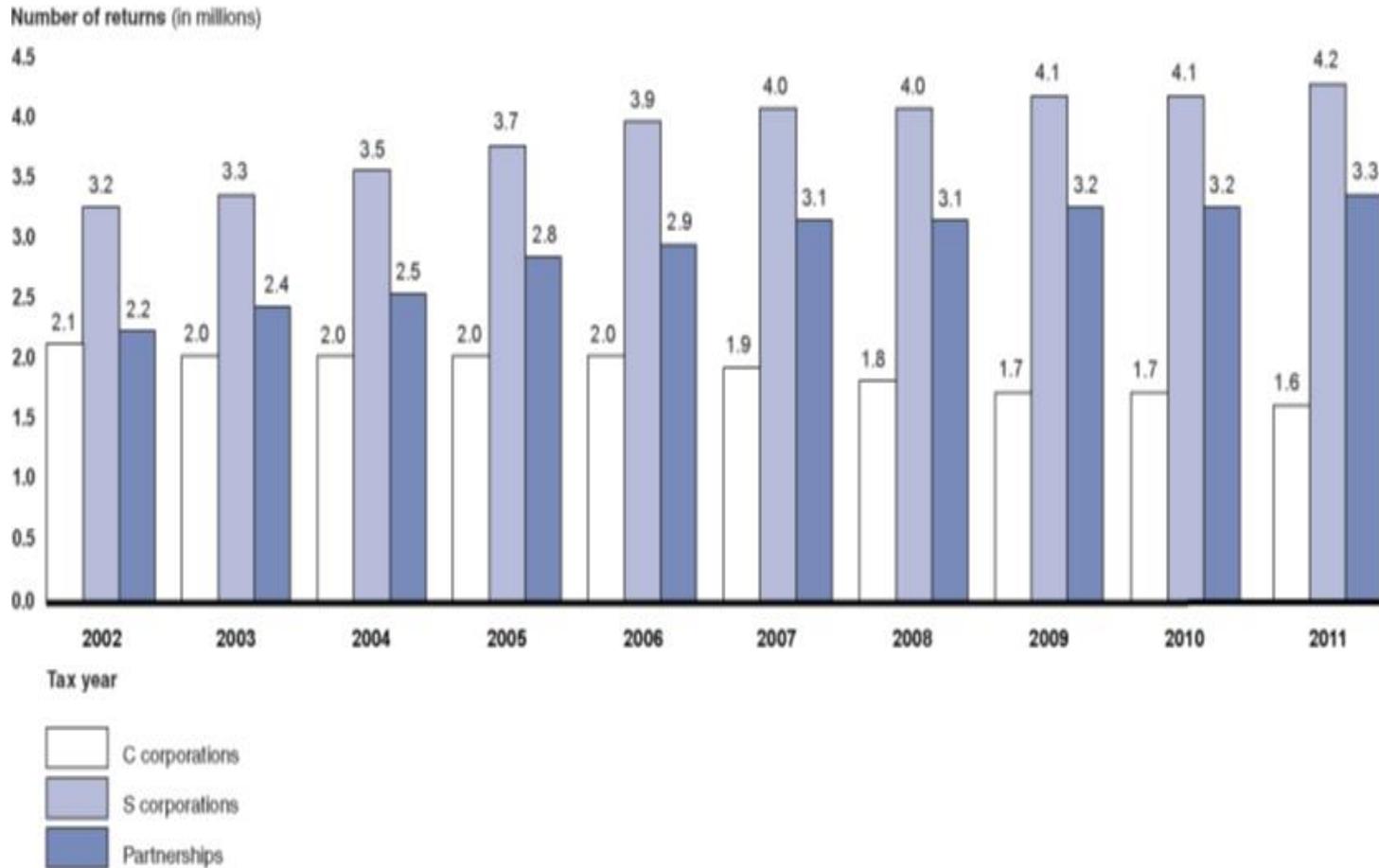
Critical Issue for States: past-year adjustments will be reflected on current year liability.

Are new state statutes called for?

What more should the states be doing to audit and track partnership income?

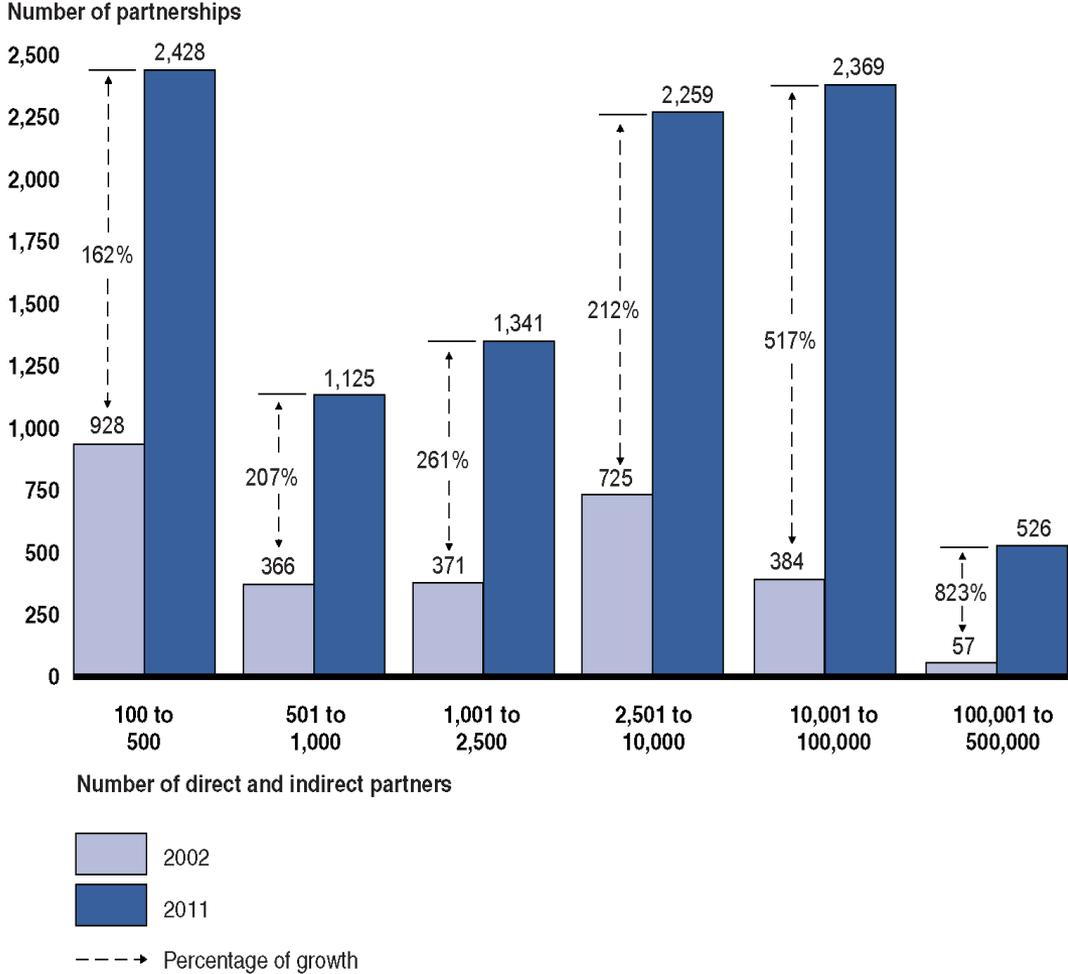
Are withholding statutes effective enough given multiple tiered entities, and how will old statutes intersect with entity-level liability?

Number of Returns by Entity Type



Source: GAO analysis of IRS data. | GAO-14-732

Direct and Indirect Partners



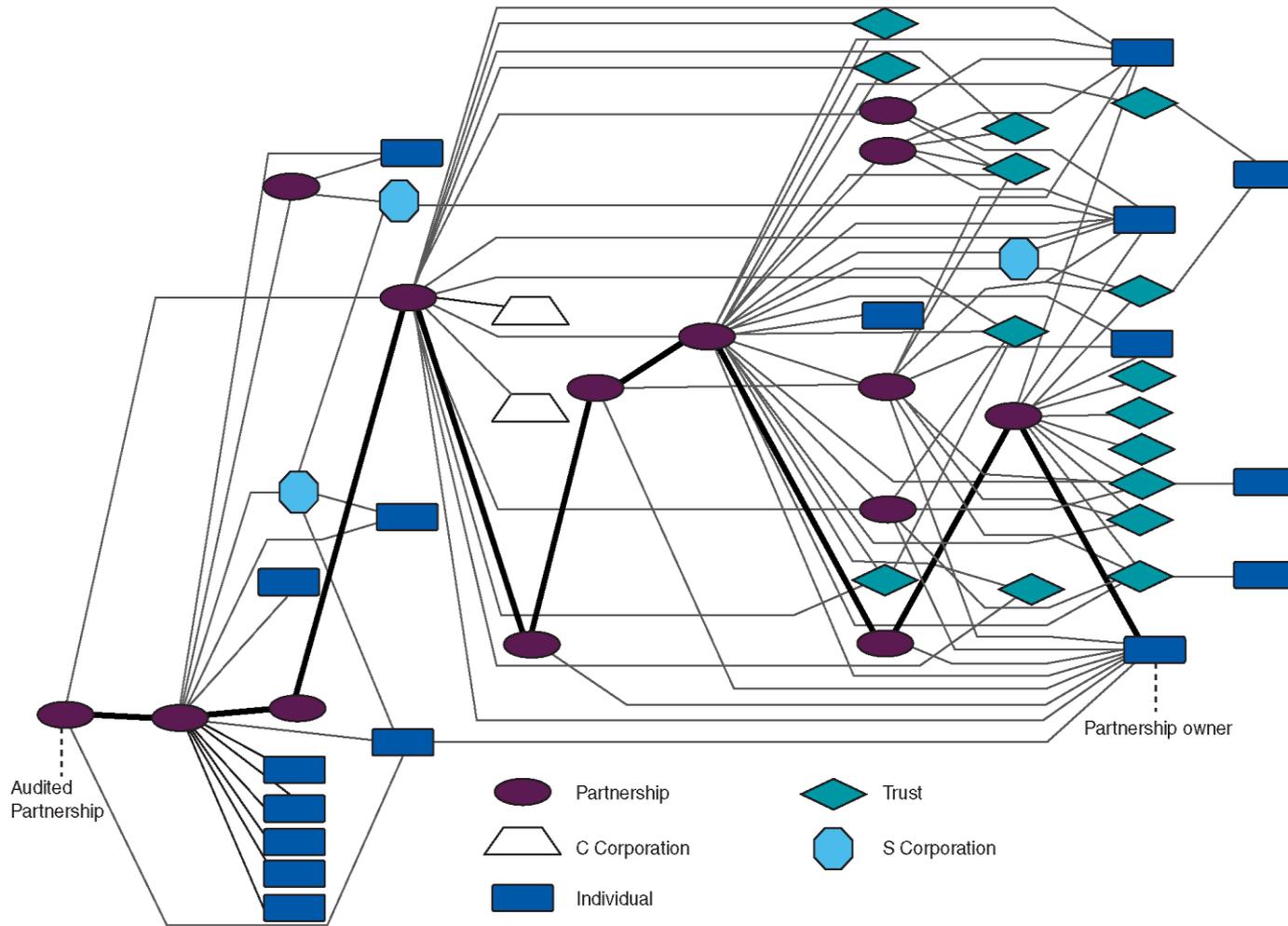
Source: GAO analysis of IRS data from Enhanced Large Partnership Indicator File and Business Returns Transaction File, Compliance Data Warehouse. | GAO-14-732

Large Partnerships by Industry Groups

Industry Group	Tax Year									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mining	18	32	35	44	76	99	131	129	127	170
Manufacturing	23	25	27	39	56	85	105	108	116	142
Transportation and Warehousing	43	43	51	40	56	61	92	87	96	114
Finance and Insurance	1,799	2,195	2,715	3,190	4,731	5,707	5,530	6,124	5,955	7,333
Real Estate, Rental, and Leasing	695	685	782	870	1,081	1,275	1,486	1,401	1,287	1,507
Professional, Scientific, and Technical Services	55	57	69	74	85	86	108	109	98	129
Holding Companies	56	53	72	89	113	157	186	200	193	233
Other	143	152	198	256	320	403	446	442	387	471

Source: GAO analysis of IRS data from the Enhanced Large Partnership Indicator (ELPI) File and Business Returns Transaction File, Compliance Data Warehouse. | GAO-14-732

Example of Partnership Structure

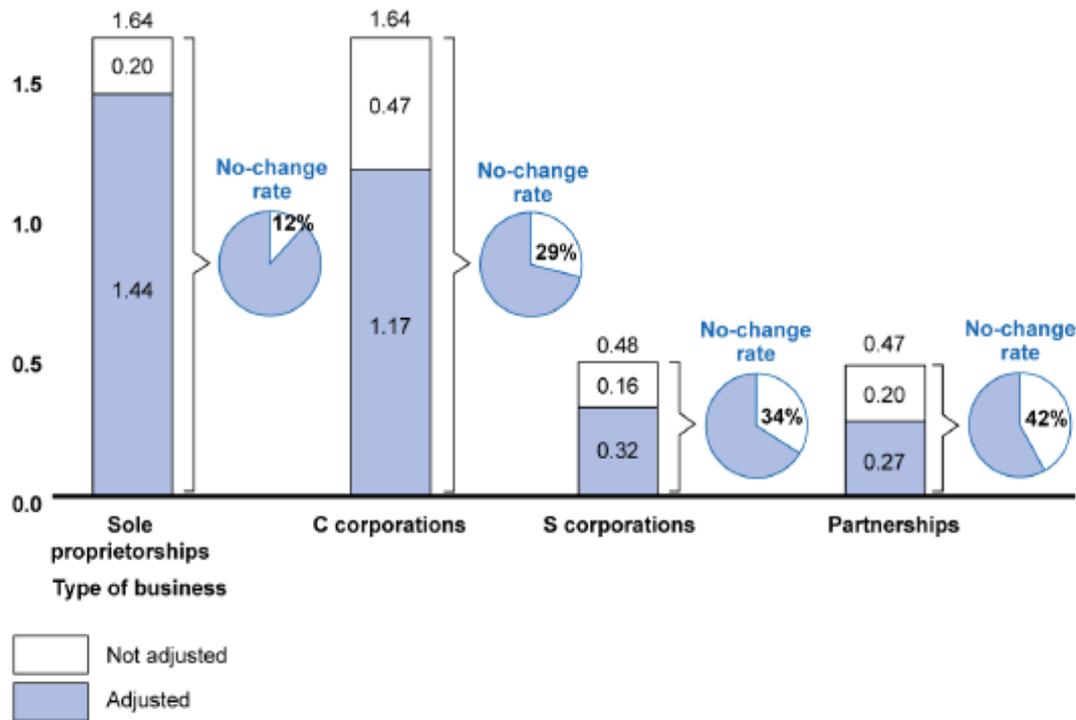


Source: GAO analysis of IRS documentation. | GAO-14-732

IRS Audit Adjustment Rates

Figure 5: Fiscal Year 2012 Examination and Adjustment Rates for Different Types of Tax Returns

Percentage examined
2.0



Source: IRS.

What the New Law Provides

- Applies to tax years beginning 1/1/18

-*But Wait*, Partnerships Can **Elect In** for tax years beginning 11/2/15 or later;

Applies to partners with 100 members or more, or partnerships with corporate partners.

But Note, partnerships with less than 100 members can elect out for a given tax year at time return is filed;

1982 TEFRA Reporting Rules Essentially Will be Eliminated: See IRC Sec. 6231

-**Under the new audit approach, the IRS will audit the partnership's items of income, gain, loss, deduction, credit and partners' distributive shares for a particular year of the partnership (the "reviewed year").**

Tax Year and Adjustment Year Are Now Bifurcated. Problems?

Any adjustments will be made at the partnership level and taken into account by the partnership in the year that the audit or any judicial review is completed (the "adjustment year").

The Partnership can also request a refund/adjustment for prior years with the adjustments applied to current (final resolution) year.

Problems?

How will this affect state personal income tax returns already filed?

RAR reporting?

New partners could be liable for prior year liabilities of partnership. Due Process issues at state level? Statute of Limitations? Binding on partners in state proceedings?

But, Partnership Can Elect to Send Tax Due Notices to Prior Partners for Audit Year Adjustments instead. (45 days from proposed final adjustment notice): How will states keep track?

Imposition of Tax at Entity Level

1. (Imputed) underpayment is assessed and collected at the partnership level, unless partnership issues notice to partners.
2. Other adjustments will be taken into account by the partnership in the adjustment year as:
 1. a reduction in non-separately stated income or
 2. an increase in non-separately stated loss.

IRS will issue a proposed notice of adjustment and provide 270 days for the partnership to contest and modify the proposed adjustment, e.g., by showing some partners have lower rates or are exempt from tax.

Congress.gov Description of New Partnership Rules; H.R. 1314, the Bipartisan Budget Act of 2015

TITLE XI--REVENUE PROVISIONS RELATED TO TAX COMPLIANCE

(Sec. 1101) This section amends the Internal Revenue Code to revise rules for audits of large for-profit partnerships (partnerships with more than 100 partners). Existing audit rules for such partnerships are repealed and partnerships with fewer than 100 partners are granted an election to opt out of the provisions of this Act.

The new audit rules require that: (1) any adjustment to items of partnership income, gain, loss, deductions, or credits be determined at the partnership level, instead of for each individual partner; (2) each partner's return be consistent with the partnership return; (3) each partnership designate a partner or other person with a substantial presence in the United States as the partnership representative to act as the sole authority on behalf of the partnership; and (4) notice be given to the partnership and the partnership representative of any administrative proceeding initiated at the partnership level, of any proposed partnership adjustment resulting from such proceeding, and of any final partnership adjustment resulting from such proceeding.

The partnership may file a petition for readjustment of any partnership item within 90 days after the date on which a notice of a final partnership adjustment is mailed to the partnership. The petition may be filed with the U.S. Tax Court, a U.S. district court for the district in which the partnership's principal place of business is located, or the U.S. Court of Claims.

The period for making adjustments to a partnership return is limited to the date that is three years (six years in the case of a substantial omission of income) after the latest of the date on which the partnership return was filed, the return due date for the taxable year, or the date on which the partnership filed an administrative adjustment request. No limit applies in the case of a false or fraudulent partnership return or if no return is filed.

(Sec. 1102) This section sets forth a rule with respect to partnership interests created by gift to provide that in the case of a capital interest in a partnership in which capital is a material income-producing factor, the determination of whether a person is a partner with respect to such interest is made without regard to whether such interest was derived by gift from any other person. This new rule applies to partnership taxable years beginning on or after January 1, 2015.

Some State Statutes and Regulations Should Ease Administrative Problems

Massachusetts General Laws Ch. 62C, Sec. 24A:

- Section 24A. (a) Members or indirect owners of a pass-through entity shall report items of income, expense or credit derived from the pass-through entity in a manner consistent with the reporting of the pass-through entity, except to the extent that a taxpayer member or indirect owner makes a declaration of inconsistency with its original return.
- (b) The commissioner shall establish by regulation unified audit procedures. The commissioner may audit, in a unified proceeding, a pass-through entity 1 or more of whose members or indirect owners are subject to tax under chapters 62 or 63; provided, however, that nothing in this section shall limit the ability of the commissioner to audit or assess individual members or indirect owners with respect to items derived from a pass-through entity or the ability of the commissioner to inspect books and records of a pass-through entity outside of a unified audit procedure. The determination of pass-through entity items shall be binding on all members and indirect owners participating in the unified audit procedure.

Pennsylvania

- **§ 9.11. Taxation of partnerships, associations and Pennsylvania (PA) S Corporations having nonresident partners, members or shareholders.**
- (a) *General.*
- (1) For taxable years beginning on or after January 1, 1992, partnerships, associations and PA S corporations with taxable income from sources within this Commonwealth are:
 - ***(i) Liable jointly with their nonresident partners, members or shareholders for payment of tax on the income to the extent allocable to the nonresident partners, members or shareholders.***
 - (ii) Authorized and required to withhold the tax from nonresident partners, members or shareholders.
 - (iii) Required to remit the tax to the Department.
- (2) The imposition of the withholding requirement against the partnership, association or PA S corporation does not change the filing requirements nor the tax liability of its nonresident partners, members or shareholders. Nonresident partners, members or shareholders may take credit on their annual returns for their share of the withholding tax paid by the partnership, association or PA S corporation. Estimated tax paid by a nonresident partner, member or shareholder may not be deducted from the tax imposed on the partnership, association or PA S corporation.

Uniformity Follow-Up?

Or should we just keep puffing along?

