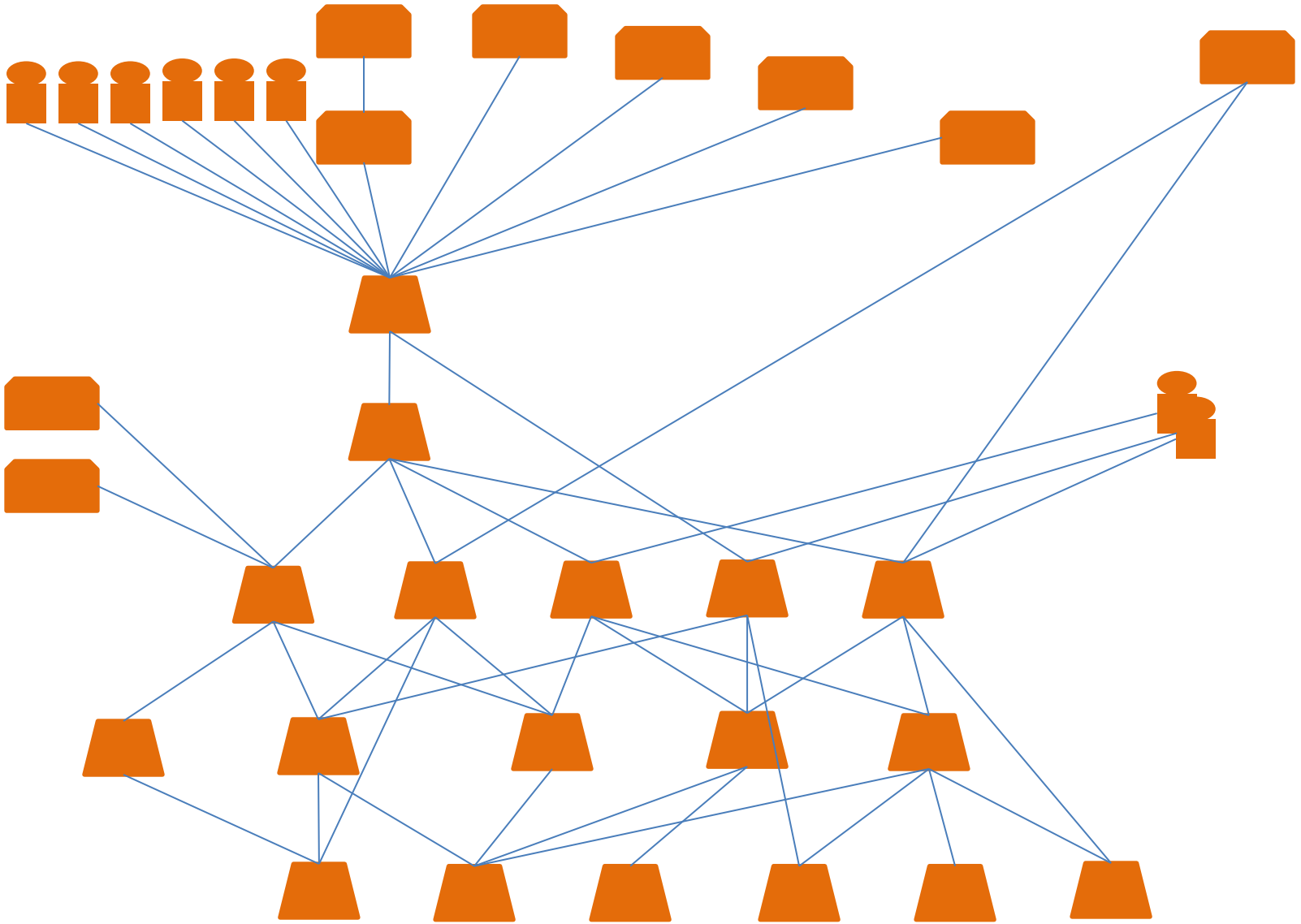
Partnership Tax – Developing Issues

Winter Meeting of the MTC Uniformity Committee
Salt Lake City
March 2, 2016

Partnership Tax - Developing Issues

OVERVIEW

Complex Partnership Structures



Substantive Rules

- Nexus over out-of-state partners of an in-state partnership
- Nexus over out-of-state partnership with in-state partners
- Apportionment issues
- Federal conformity
- Deductions and credits for tax paid by resident individual partners

Enforcement Provisions

- Withholding and composite rules
- Audit adjustment rules - generally
- Conformity with federal rules

Partnership Tax – Substantive Rules

OVERVIEW

Nexus Over Out-of-State Partners

- Where the partner is an individual
  - General versus limited partner
  - Majority versus minority partner
  - Operational/managerial involvement versus no involvement
  - Direct versus indirect interest (first-tier versus lower tier partnerships)
- Where the partner is a corporation
  - Same issues
  - Where the corporation is not unitary with the partnership

Nexus Over Out-of-State Partnerships

- Importance for compliance purposes
- Where the instate partner is
  - Individual versus corporation
  - General versus limited
  - Majority interest holder versus minority
  - Involvement in the partnership versus no involvement
  - Direct or indirect (first tier versus lower tier)
- Purpose of asserting nexus
  - Requirement to file information returns
  - Ability to audit

Apportionment

- Resident partners
- Nonresident partners
  - Apportionment versus allocation
  - Multi-tiered entities
  - Special allocations
- Corporate partners
  - Unitary versus non-unitary partnerships
  - Apportionable versus non-apportionable income
  - Multi-tiered entities
  - Special allocations

Federal Conformity

- Add-back and subtraction rules
- Decoupling issues generally
- Related party transactions

Deductions & Credits for Tax Paid

- In states that allow a deduction for federal tax paid – will they allow taxes paid at the entity level to be deducted?
- What about credits for state taxes paid at the partnership level?

Partnership Tax – Enforcement Provisions

OVERVIEW

Withholding and Composite Rules

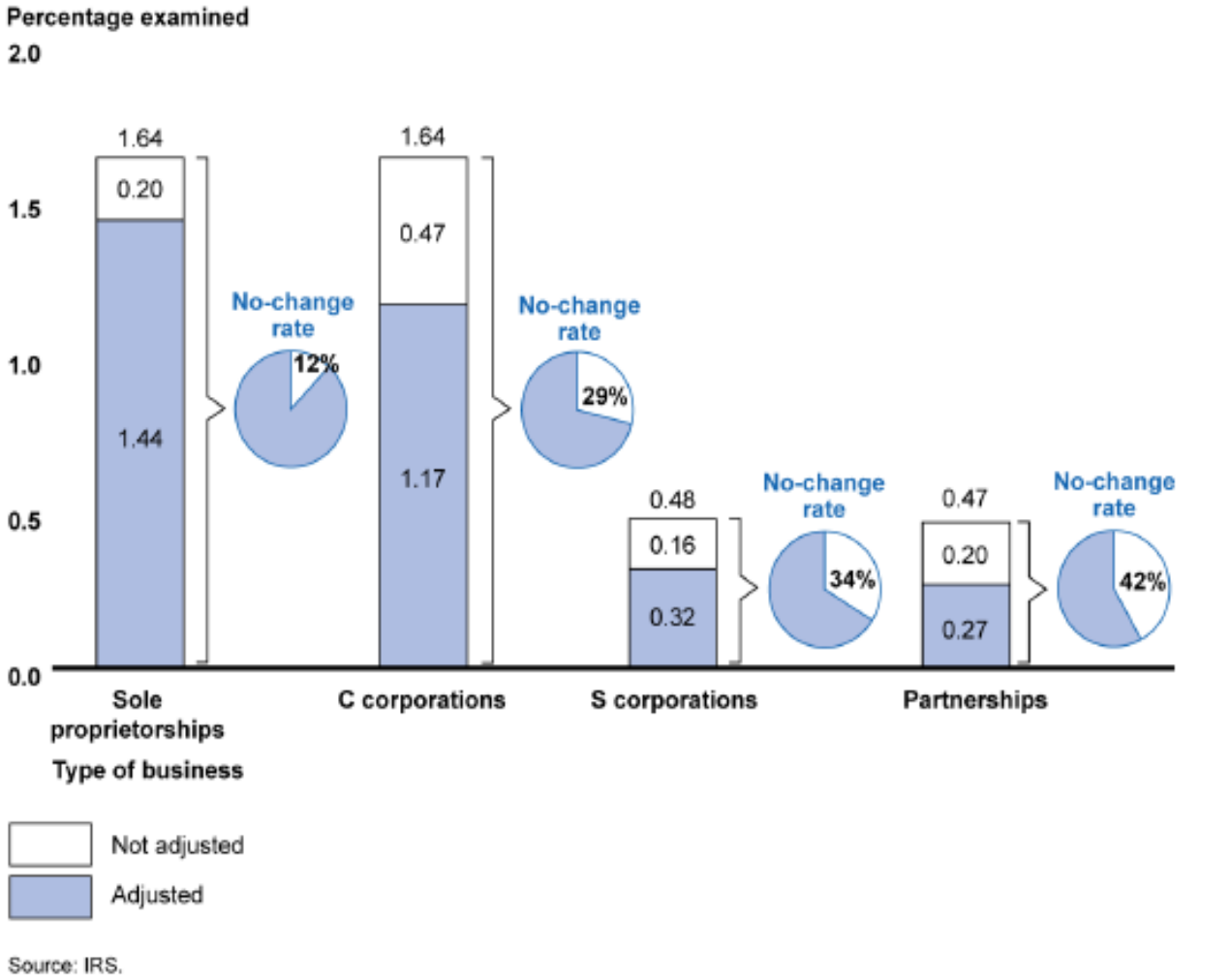
- Does the MTC model need to be updated?
  - Multi-tiered entities
  - Joint and several liability
  - Other enforcement related issues

Audit & Adjustment Rules - Generally

- Auditing at the partnership level?
  - Ability to require partnerships doing business in the state to provide records.
  - Ability to require partnerships not doing business in the state—but with resident partners—to provide records.
  - Mult-tiered entities.
- Designation of a partnership representative
- Ability to require amended returns
- Partnership-requested adjustments

IRS Audit Adjustment Rates

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



Source: IRS.

Bipartisan Budget Act of 2015 (PL 114-74)

- Title XI – Revenue Provisions Related to Tax Compliance
  - Sec. 1101 Partnership audits and adjustments
  - Sec. 1102 Partnership interests created by gift
- Repeals TEFRA Audit rules and electing large partnership rules.
- Enacts partnership audit reform
- Effective for tax years beginning 2018 – but can be elected starting this year for requested adjustments

Main Provisions of the Audit Reform Rules

- Partnership will pay tax, interest and penalties related to adjustments – calculated at the highest statutory rate (as determined under the rules). Partners' shares of the adjustments flow through to partners in the year the adjustment is made.

- OR

- Partnerships may elect to issue adjusted Schedule K-1s ("Special K") to the partners in the reviewed year who would then report the adjustments in the year the adjustment is made. IRS must collect from the partners.

Other Provisions of the Audit Reform Rules

- Small partnerships with 100 or fewer qualifying partners may elect out of the new rules altogether and the pre-TEFRA rules will apply to those partnerships. (Lower tiered partnerships in a multi-tiered structure generally cannot elect out.)
- Partnerships are represented in the audit by a "partnership representative" who can be a non-partner.

Conformity with Federal Rules

- Federal adjustments made at the partnership level
- Federal adjustments made in the current year through issuance of amended K-1's
- Treatment of intervening periods
- Specific state-related issues
  - Special allocation of state tax items (e.g. credits)
  - Effect of federal audit changes on state apportionment

Other Consideration

- IRS will issue regulations this year implementing the new audit and adjustment rules.
- There is little data on partnership issues but the MTC could make an effort to find as much existing data as possible.