

Concept Paper – For Discussion Purposes Only

To: Helen Hecht, MTC General Counsel; Holly Coon, Chair, MTC Uniformity Committee; and Tracee Able, Chair, MTC Partnership Work Group

From: Nikki Dobay, COST, and Pilar Mata, TEI

CC: MTC Uniformity Committee Members; Greg Matson, MTC Executive Director

Date: March 8, 2017

Re: Interested Parties¹ Concept Paper for Model Legislation Jointly Addressing the Reporting of Federal Tax Adjustments and Federal Partnership Audits

The Interested Parties plan to complete model legislation improving the procedure for taxpayers to report federal income tax changes, and providing a procedure for reporting changes resulting from the Bipartisan Budget Act of 2015's (BBA) federal partnership audit regime, by the end of June 2017. Accordingly, we recommend that the MTC Partnership Work Group address issues associated with reporting federal tax changes jointly with its ongoing work regarding addressing states' implementation of the federal partnership audit changes. Improving the process for taxpayers to report federal adjustments, including the results of a partnership audit conducted by the Internal Revenue Service (IRS) for tax years beginning on and after January 1, 2018, go hand-in-hand.

The Interested Parties presented the Uniformity Committee with draft model legislation addressing the reporting of federal audit changes at its December 14, 2016 meeting. The Interested Parties will be supplementing this draft model with provisions to address the federal partnership audit rules and other federal tax adjustments (including taxpayer-initiated amended returns). The Interested Parties anticipate the following key concepts will be part of that model legislation:

- 1) **The Default Method:** The partnership files a "post-federal audit group return" for all partners (resident, non-resident, otherwise ineligible entities) in any state where returns (individual or partnership) were originally filed for the reviewed year and pays the tax on behalf of the partners.
- 2) **The Modified Default Method:** The partnership files a "post-federal audit group return" for the partners; however, partners who are residents of the state may be excluded from the "post-federal audit group return" filed in that state. Resident partners not included in the "post-federal audit group return" would be required to use the Optional Elective Method, described below.
- 3) **The Optional Elective Method:** The partnership files an amended information return with the state for the reviewed year and provides all reviewed year partners with amended K-1 Schedules, including any state-specific information, so they can file amended returns and pay the appropriate tax.

¹ At the present time, the "Interested Parties" are the Council On State Taxation (COST), Tax Executives Institute (TEI), American Institute of CPAs (AICPA), and the State and Local Tax Committee of the American Bar Association Tax Section. The methods described in this concept paper are for discussion purposes only and have not been officially endorsed by these organizations.

Notes Applicable to Above Methods

- A partnership's election can vary from state to state;
- A state may require reviewed year partners to use the Optional Elective Method if their partnership is insolvent, dissolved, or does not timely comply/remit the tax due under the Default Method;
- Allocation and apportionment calculations would be based on the reviewed year data, adjusted (if necessary) for changes resulting from the federal audit; and
- Partnership's selection of a Partnership Representative at the federal level would apply to the state unless the partnership selects a specific state "Partnership Representative."

Improving the Procedure to Report Federal Audit Changes

The states' procedures for taxpayers to report federal partnership audit changes would likely be in the same statute or chapter containing the currently widely-divergent procedures for the reporting all federal income tax audit adjustments.² It would be inefficient and unreasonable to address only part of the law pertaining to federal changes, especially given the complexity and the administrative burdens that taxpayers already face in this area. Therefore, the Interested Parties request the following administrative improvements be included as part of any federal partnership audit conformity legislation and applied to all taxpayers when reporting federal adjustments:

- Comprehensive definition of a "final determination" to clarify when a federal tax change needs to be reported to a state;
- Streamlined form(s) to report such changes that is not due until at least 180 days after the final determination;
- Optional *de minimis* exception for insignificant changes to report to a state;
- Limit assessments and refunds when a state's normal statute of limitations has expired to those directly resulting from the federal audit;
- Clear statute of limitations for amended returns/reports that are filed with a state and for those that are not filed; and
- Allow estimated state tax payments prior to completion of a federal audit without filing an amended return, with the ability to obtain a refund if the amounts paid as estimates prove to be greater than the final state tax liability.³

We thank you for your time and consideration in this important matter.

² For example, see Arizona's S.B. 1288 (2016) and legislation introduced this year in Georgia (H.B. 283 as introduced), Minnesota (H.F. 1227), Missouri (S. 521), and Montana (H.B. 47).

³ These recommendations were proposed to the Uniformity Committee at its meeting in December 2016.