

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

**DISCUSSION DRAFT**

**With Technical Correction as of November 2020 and  
Additional Note for States Adopting the Model**

**Technical Correction Adopted November 2020**

Technical corrections have been made to the model, adopted in 2019. Those technical corrections primarily address negative federal adjustments arising from partnership audits or administrative adjustment requests (AARs). A “federal adjustment,” as defined in the model, is a change in a tax item (character, timing, or amount) used in calculating state tax. A negative federal adjustment is a change that reflects a state tax overpayment.

*Background*

Negative federal adjustments which may result from a federal centralized partnership audit or an AAR may be treated in different ways, depending on the circumstances and applicable rules. Some negative and positive federal adjustment may be netted if they fall into the same category of items as determined under IRC §702 and applicable regulations, subject to IRS discretion. (See IRC §6225(b)(1)(A) and (b)(3)). But reallocation adjustments may not be netted. (See IRC §6225(b)(2)). If negative adjustments are not netted then they will be “adjustments that do not result in an imputed underpayment,” as that term is used in IRC §6225.<sup>1</sup>

Under IRC §6225-6227 and applicable IRS regulations, there are generally two ways in which these negative adjustments “that do not result in an imputed underpayment” may be treated for federal purposes. In some cases, they may be subject to the push-out treatment of IRC §6226. If they are pushed out, then, as with positive federal adjustments, partners will compute the tax difference for the reviewed year and will report the under- or over-paid amount either as “other tax” or a nonrefundable credit on their adjustment year returns. In this case, states will need to provide for a mechanism to report those adjustments and pay additional state tax or claim a refund.

Alternatively, some negative adjustments that do not result in an imputed underpayment,

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<sup>1</sup>Note that decoupling from federal tax law could potentially change the effect of particular federal adjustments on state tax. Take, for example, a federal audit that determines that the partnership COGS expense is overstated but that depreciation expense is understated, and nets these two adjustments. If the state has decoupled from federal depreciation expense, then it would pick up the positive federal adjustment to COGS, but not the negative federal adjustment to depreciation. In other words, it would not allow netting of these adjustments for state purposes.

mainly resulting from a partnership audit, may be “taken into account by the partnership in the adjustment year” through the inclusion of the negative amount as a tax item on the partnership return for the adjustment year. That negative adjustment amount would be netted against other tax items in the same category on that adjustment year return and would be allocated to the partners in that year, following IRS regulations. (See IRC §6225(a)(2) and 26 CFR §301.6225-3.) It appears that approach will be followed even though partners in the reviewed year and the adjustment year are not the same—with the exception that the negative side of reallocation adjustments will be allocated only to partners that were reviewed year partners (and who were over-allocated the amounts in that year). (See 26 CFR §301.6225-3(b)(4).

Where negative federal adjustments are taken into account by the partnership by including those items in the partnership return for the adjustment year, then for states that begin their tax calculation with the federal partnership returns, and Schedule K-1s, the effect of these adjustments will flow through to the state. For the state to then allow a separate refund claim for those negative adjustments would be to effectively double-count them. The model, therefore, excluded these negative adjustments from the refund provisions of Section G.

It is important to note that a single audit may result in multiple imputed underpayments. The IRS retains the discretion to group federal adjustments together in computing multiple imputed underpayments for various reasons, including to assist in the timely resolution of the underlying issues. So, for example, a single audit may result in 6 discrete adjustments to the reviewed year returns—revaluing certain items, recharacterizing other items, and reallocating particular items. These audit adjustments may include negative (offsetting) adjustments, which may or may not be netted. As noted below, this possibility was taken into account in making technical corrections to the model.

#### *Need for Technical Corrections*

Section G of the model generally provides for state tax refunds in the case of negative federal adjustments. The model assumes states begin their calculation with amounts on the federal Form 1065 and Schedule K-1. Therefore, when negative federal adjustments are required to be taken into account by the partnership by including those adjustments in the federal return for the adjustment year, the model excludes those adjustments from Section G so as not to double-count their effects.

In excluding these negative federal adjustments from Section G, however, the model provisions simply referenced IRC section 6225(a)(2), which contains the general rule. This reference to IRC section 6225(a)(2) may not be sufficient since it appears that some adjustments subject to section 6225(a)(2) will be pushed out under Section 6226, rather than flowing through the adjustment year partnership return.

Therefore, the technical corrections clarify that if federal adjustments are “negative federal adjustments required by federal law or regulations to be taken into account by the partnership in the partnership return for the adjustment or other year through inclusion in the partnership return for that year,” they are excluded from the provision allowing for a separate state tax refund claim.

In addition, Section G of the model did not clearly provide for claiming state tax refunds based on negative federal adjustments resulting from Administrative Adjustment Requests (AARs) at the time the AAR is filed, because it used the term “made by the IRS.” This led to some confusion over the intention of Section G.

An explanation of each related technical correction follows:

- Section B (providing for reporting of final federal adjustments, and paying the tax owed, on adjustments other than partnership adjustments). The correction removes a reference to adjustments “reported for federal purposes pursuant to IRC section 6225(a)(2)” in the exclusion from Section B. This reference is unnecessary since Section B has to do with reporting additional taxes due and applies only to non-partnership adjustments. Removing this reference is also consistent with the other related technical corrections.
- Section C (providing for the reporting of final federal adjustments, and the paying of state tax owed, on partnership adjustments). The correction removes a reference to adjustments “required to be reported for federal purposes pursuant to IRC section 6225(a)(2)” from the exclusion to Section C and inserts, instead, language to clarify that the reporting of any federal adjustments under this section excludes “negative federal adjustments required under federal law or regulations to be taken into account by the partnership in the partnership return for the adjustment or other year.” While Section C, like Section B, also relates only to the reporting of additional taxes due, this exclusion was retained to make clear that in a case where an audit results in multiple imputed underpayments, if this results in a particular negative adjustment being taken into account by the partnership in the adjustment year return, then it cannot be included to offset other positive federal adjustments (that may have been used to compute other federal imputed underpayments). Essentially, this is a guard against any double-counting of the effect of a negative adjustment that is going to flow through the partnership return in the adjustment year.
- Section G (providing for claims for refund arising from federal adjustments):
  - Adds “or by Administrative Adjustment Request” to the title to clarify that the provision covers refunds claimed based on adjustments from AARs;
  - Removes “Final Federal Adjustments required to be reported for federal purposes under IRC section 6225(a)(2)” from the exception from Section G

and inserts “negative Federal Adjustments required by federal law or regulations to be taken into account by the partnership in the partnership return for the adjustment or other year;”

- Removes the term “made by the IRS” in reference to Federal Adjustments and inserts the term “Final” to clarify that the adjustments to which Section G applies are those that are Final, as defined in the model, which may include adjustments arising from an AAR; and
- Clarifies that the term “Taxpayer” in Section G(2) includes the Partnership and its Tiered Partners, Direct Partners, and Indirect Partners, all of which may be required to file in order to have a proper state tax refund claim.

In addition, to these technical corrections, a change was made to Section C(5) allowing the revenue agency to provide for a modified method of claiming a refund of state tax by the partnership “if the Audited Partnership or Tiered Partner can show that their direct partners have agreed to allow a refund of the state tax to the entity.” Section G then provides that in such case—“Any refund granted to the entity under Section C is in lieu of state tax that may be owed to the partners.” In addition, a drafter’s note was added in the text of this section noting that the intent of this provision is to provide the agency with authority for alternative reporting only provided that such alternative reporting would otherwise conform to state law.

### **Additional Note for States Adopting the Model with an Effective Date Subsequent to the Final Determination Date of Certain Adjustments**

As of November 2020, there are still states that have not adopted the model or similar provisions. It is possible that the final determination date (which triggers filing requirements and deadlines) for certain federal adjustments, especially those arising from AARs, may pass before the effective date of state law. States should therefore consider modifying the definition of the term “final determination date” to include a date certain, effectively extending the final determination date for federal adjustments that result from actions prior to the effective date. For example, a state may consider modifying the definition of “final determination date” to include such language as: . . . the Final Determination Date is *the later of the effective date of this Act or . . .*”.

### **Drafters’ 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.

Also note that the draft contains a definition of “reallocation adjustment” which was originally included with the expectation that states might treat reallocation adjustments differently. Ultimately, it was determined that the states ought to follow the federal treatment of reallocation adjustments (including the tax-positive side in the partnership pays amount, but not the tax-negative side); however, the definition was not removed.

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

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

DRAFT

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

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## 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 filed  
4 by a Partnership under IRC section 6227.

5 **(2) “Audited Partnership”** means a Partnership subject to a Partnership Level Audit resulting  
6 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>2</sup>].

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

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

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

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

26 (a) Except as provided in Section A(9)(b) and (c), if the Federal Adjustment arises from an  
27 IRS audit or other action by the IRS, the Final Determination Date is the first day on which no  
28 Federal Adjustments arising from that audit or other action remain to be finally determined,  
29 whether by IRS decision with respect to which all rights of appeal have been waived or ex-  
30 hausted, by agreement, or, if appealed or contested, by a final decision with respect to which all  
31 rights of appeal have been waived or exhausted. For agreements required to be signed by the  
32 IRS and the Taxpayer, the Final Determination Date is the date on which the last party signed  
33 the agreement.

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<sup>2</sup> Drafting note: This portion of definition should only be used by the [State] if it taxes unrelated business income.

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

5 (c) If the Federal Adjustment results from filing an amended federal return, a federal refund  
6 claim, or an Administrative Adjustment Request, or if it is a Federal Adjustment reported on an  
7 amended federal return or other similar report filed pursuant to IRC section 6225 (c), the Final  
8 Determination Date means the day on which the amended return, refund claim, Administrative  
9 Adjustment Request, or other similar report was filed.

10 **(10) "Final Federal Adjustment"** means a Federal Adjustment after the Final Determination  
11 Date for that Federal Adjustment has passed.

12 **(11) "Indirect Partner"** means a Partner in a Partnership or Pass-Through Entity that itself  
13 holds an interest directly, or through another Indirect Partner, in a Partnership or Pass-Through En-  
14 tity.

15 **(12) "IRC"** means the Internal Revenue Code of 1986, as codified at 26 United States Code  
16 (U.S.C.) Section 1, et seq., [insert State's current practice to incorporate IRC] and applicable regula-  
17 tions as promulgated by the U.S. Department of the Treasury.<sup>3</sup>

18 **(13) "IRS"** means the Internal Revenue Service of the U.S. Department of the Treasury.

19 **(14) "Non-Resident Partner"** means an individual, trust, or estate Partner that is not a Resident  
20 Partner.

21 **(15) "Partner"** means a person that holds an interest directly or indirectly in a Partnership or  
22 other Pass-Through Entity.

23 **(16) "Partnership"** means an entity subject to taxation under Subchapter K of the IRC.

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

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

29 **(19) "Reallocation Adjustment"** means a Federal Adjustment resulting from a Partnership  
30 Level Audit or an Administrative Adjustment Request that changes the shares of one or more items  
31 of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive Realloca-  
32 tion Adjustment means the portion of a Reallocation Adjustment that would increase federal income  
33 for one or more Direct Partners, and a negative Reallocation Adjustment means the portion of a

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<sup>3</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."

1 Reallocation Adjustment that would decrease federal income for one or more Direct Partners [pur-  
2 suant to Regulations under IRC section 6225].

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

5 **(21) “Reviewed Year”** means the taxable year of a Partnership that is subject to a Partnership  
6 Level Audit from which Federal Adjustments arise.

7 **(22) “Taxpayer”** means [insert reference to State definition] and, unless the context clearly in-  
8 dicates otherwise, includes a Partnership subject to a Partnership Level Audit or a Partnership that  
9 has made an Administrative Adjustment Request, as well as a Tiered Partner of that Partnership.

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

11 **(24) “Unrelated Business Taxable Income”** has the same meaning as defined in IRC section  
12 512.<sup>4</sup>

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

14 Except in the case of Final Federal Adjustments that are required to be reported by a Partnership and  
15 its Partners using the procedures in Section C, ~~and Final Federal Adjustments required to be reported~~  
16 ~~for federal purposes under IRC section 6225(a)(2)~~, a Taxpayer shall report and pay any [State] tax  
17 due with respect to Final Federal Adjustments arising from an audit or other action by the IRS or  
18 reported by the Taxpayer on a timely filed amended federal income tax return, including a return or  
19 other similar report filed pursuant to IRC section 6225(c)(2), or federal claim for refund by filing a  
20 Federal Adjustments Report with the [State Tax Agency] for the Reviewed Year and, if applicable,  
21 paying the additional [State] tax owed by the Taxpayer no later than 180 days after the Final Deter-  
22 mination Date.

### 23 **Section C. Reporting Federal Adjustments – Partnership Level Audit and Administrative Ad- 24 justment Request**

25 Except for ~~negative Federal adjustments~~ Adjustments required under federal law or regulations to be  
26 reported for federal purposes pursuant to IRC section 6225(a)(2) taken into account by the partner-  
27 ship in the partnership return for the adjustment or other year, and the distributive share of adjust-  
28 ments that have been reported as required under Section B, Partnerships and Partners shall report  
29 Final Federal Adjustments arising from a Partnership Level Audit or an Administrative Adjustment  
30 Request and make payments as required under this Section C.

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

32 (a) With respect to an action required or permitted to be taken by a Partnership under this  
33 Section C and a proceeding under [reference to provisions for State administrative appeal or  
34 judicial review] with respect to that action, the State Partnership Representative for the Re-  
35 viewed Year shall have the sole authority to act on behalf of the Partnership, and the

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

1 Partnership's Direct Partners and Indirect Partners shall be bound by those actions.

2 (b) The State Partnership Representative for the Reviewed Year is the Partnership's Federal  
3 Partnership Representative unless the Partnership designates in writing another person as its  
4 State Partnership Representative.

5 (c) The [State Tax Agency] may establish reasonable qualifications for and procedures for  
6 designating a person, other than the Federal Partnership Representative, to be the State Partner-  
7 ship Representative.

8 **(2) Reporting and Payment Requirements for Partnerships Subject to a Final Federal Ad-**  
9 **justment and their Direct Partners.** Final Federal Adjustments subject to the requirements of this  
10 Section C, except for those subject to a properly made election under Section C(3), shall be reported  
11 as follows:

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

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

15 (ii) Notify each of its Direct Partners of their distributive share of the Final Federal Ad-  
16 justments including information as required by the [State Tax Agency regulation]; and

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

22 (b) [Except as provided under State law for minimal tax liabilities]<sup>5</sup>, no later than 180 days  
23 after the Final Determination Date, each Direct Partner that is taxed under [reference to State  
24 law imposing tax on individuals, trusts, estates, C corporations, etc.] shall:

25 (i) File a Federal Adjustments Report reporting their distributive share of the adjust-  
26 ments reported to them under Section C(2)(a)(ii) as required under [reference to State  
27 laws]; and

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

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

34 (a) No later than 90 days after the Final Determination Date, file a completed Federal Ad-  
35 justments Report, including information as required by the [State Tax Agency rule or

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<sup>5</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 instruction], and notify the [State Tax Agency] that it is making the election under this Subsec-  
2 tion (3);

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

5 (i) Exclude from Final Federal Adjustments the distributive share of these adjustments  
6 reported to a Direct Exempt Partner not subject to tax under [reference state law taxing  
7 certain income to tax-exempt entities].

8 (ii) For the total distributive shares of the remaining Final Federal Adjustments re-  
9 ported to Direct Corporate Partners subject to tax under [reference to State law] and to  
10 Direct Exempt Partners subject to tax under [reference state law taxing certain income to  
11 tax-exempt entities], apportion and allocate such adjustments as provided under [reference  
12 to existing multi-state business activity allocation/apportion law or regulation] and multi-  
13 ply the resulting amount by the highest tax rate under [reference to State law(s)];

14 (iii) For the total distributive shares of the remaining Final Federal Adjustments re-  
15 ported to Non-Resident Direct Partners subject to tax under [reference to State law apply-  
16 ing to individuals and /or trusts], determine the amount of such adjustments which is  
17 [State]-source income under [reference to existing non-resident partner sourcing law or  
18 regulation], and multiply the resulting amount by the highest tax rate under [reference to  
19 State law applying to individuals and/or trusts];

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

22 (A) Determine the amount of such adjustments which is of a type that it would be  
23 subject to sourcing to the [State] under [reference to existing State rules for allocat-  
24 ing/apportioning income of non-resident partners]; and then determine the portion of  
25 this amount that would be sourced to the state applying [these rules];

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

29 (C) Determine the portion of the amount determined in Section C(3)(b)(iv)(B)  
30 that can be established, under regulation issued by [State Agency], to be properly allo-  
31 cable to Nonresident Indirect Partners or other Partners not subject to tax on the ad-  
32 justments; or that can be excluded under procedures for Modified Reporting and Pay-  
33 ment Method allowed under Paragraph (5).

34 (v) Multiply the total of the amounts determined in Section C(3)(b)(iv)(A) and (B) re-  
35 duced by the amount determined in Section C(3)(b)(iv)(C) by the highest tax rate under  
36 [reference to State law applying to individuals and/or trusts];

37 (vi) For the total distributive shares of the remaining Final Federal Adjustments

1 reported to Resident Direct Partners subject to tax under [reference to State law applying  
2 to individuals and /or trusts], multiply that amount by the highest tax rate under [reference  
3 to State law applying to individuals and/or trusts];

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

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

7 DRAFTER'S NOTE: THE EXCLUSION IN (i) IS INTENDED TO ADDRESS THE PARTICULAR  
8 STATE'S LAW WITH RESPECT TO ADJUSTMENTS THAT WOULD FLOW THROUGH TO COR-  
9 PORATE PARTNERS AND MIGHT BE TREATED AS PART OF THE UNITARY BUSINESS OF  
10 THE CORPORATION.

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

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

16 (d) {OPTIONAL PROVISIONS}

17 Option A - An Audited Partnership not otherwise subject to any reporting or payment obli-  
18 gation to [State] that makes an election under this Subsection (3) consents to be subject to  
19 [State] laws related to reporting, assessment, payment, and collection of [State] tax calcu-  
20 lated under the election.

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

23 (4) **Tiered Partners.** The Direct and Indirect Partners of an Audited Partnership that are Tiered  
24 Partners, and all of the Partners of those Tiered Partners that are subject to tax under [reference to  
25 State laws imposing tax on individuals, trusts, corporations, etc.] are subject to the reporting and  
26 payment requirements of Section C(2) and the Tiered Partners are entitled to make the elections  
27 provided in Section C(3) and (5). The Tiered Partners or their Partners shall make required reports  
28 and payments no later than 90 days after the time for filing and furnishing statements to Tiered  
29 Partners and their Partners as established under IRC section 6226 and the regulations thereunder.  
30 The [State Agency] may promulgate regulations to establish procedures and interim time periods  
31 for the reports and payments required by Tiered Partners and their Partners and for making the  
32 elections under this Section C.

33 (5) **Modified Reporting and Payment Method.** [Drafter's Note: This provision is intended to  
34 allow the state to respond to requests by the partnership for an alternative means of reporting that  
35 would otherwise satisfy state law requirements for the reporting and payment of tax and, therefore,  
36 the provision allowing the partnership to request a refund to be paid to the entity should be evalu-  
37 ated by the adopting state in light of whether it would otherwise conform to state law.] Under

1 procedures adopted by and subject to the approval of the [State Agency], an Audited Partnership or  
2 Tiered Partner may enter into an agreement with the [State Agency] to utilize an alternative report-  
3 ing and payment method, including applicable time requirements or any other provision of this Sec-  
4 tion C, if the Audited Partnership or Tiered Partner demonstrates that the requested method will  
5 reasonably provide for the reporting and payment of taxes, penalties, and interest due under the  
6 provisions of this Section C, or if the Audited Partnership or Tiered Partner can show that their direct  
7 partners have agreed to allow a refund of the state tax to the entity. Application for approval of an  
8 alternative reporting and payment method must be made by the Audited Partnership or Tiered Part-  
9 ner within the time for election as provided in Section C(3) or (4), as appropriate.

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

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

14 (b) If properly reported and paid by the Audited Partnership or Tiered Partner, the amount  
15 determined in Section C(3)(b), or similarly under an optional election under Section C(5), will  
16 be treated as paid in lieu of taxes owed by its Direct and Indirect Partners, to the extent applica-  
17 ble, on the same Final Federal Adjustments. The Direct Partners or Indirect Partners may not  
18 take any deduction or credit for this amount or claim a refund of the amount in this State. Noth-  
19 ing in this Subsection(C)(6) shall preclude a Direct Resident Partner from claiming a credit  
20 against taxes paid to this State pursuant to [reference to State law], any amounts paid by the  
21 Audited Partnership or Tiered Partner on the Resident Partner's behalf to another state or local  
22 tax jurisdiction in accordance with the provisions of [State law or regulation allowing credit for  
23 taxes paid to another state or locality].

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

28 **SECTION D. De Minimis Exception**

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

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

33 The [State Agency] will assess additional tax, interest, and penalties arising from Final Federal Ad-  
34 justments arising from an audit by the IRS, including a Partnership Level Audit, or reported by the  
35 Taxpayer on an amended federal income tax return or as part of an Administrative Adjustment Re-  
36 quest by the following dates:

37 **(1) Timely Reported Federal Adjustments.** If a Taxpayer files with the [State Agency] a

1 Federal Adjustments Report or an amended [State] tax return as required within the period specified  
2 in Sections B or C, the [State Agency] may assess any amounts, including in-lieu-of amounts, taxes,  
3 interest, and penalties arising from those Federal Adjustments if [State Agency] issues a notice of the  
4 assessment to the Taxpayer no later than:

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

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

9 **(2) Untimely Reported Federal Adjustments.** If the Taxpayer fails to file the Federal Adjust-  
10 ments Report within the period specified in Sections B or C, as appropriate, or the Federal Adjust-  
11 ments Report filed by the Taxpayer omits Final Federal Adjustments or understates the correct  
12 amount of tax owed, the [State Agency] may assess amounts or additional amounts including in-  
13 lieu-of amounts, taxes, interest, and penalties arising from the Final Federal Adjustments, if it mails  
14 a notice of the assessment to the Taxpayer by a date which is the latest of the following:

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

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

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

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

22 A Taxpayer may make estimated payments to the [State Agency], following the process prescribed  
23 by the [State Agency], of the [State] tax expected to result from a pending IRS audit, prior to the due  
24 date of the Federal Adjustments Report, without having to file the report with the [State Agency]. The  
25 estimated tax payments shall be credited against any tax liability ultimately found to be due to [State]  
26 (“Final [State] Tax Liability”) and will limit the accrual of further statutory interest on that amount. If  
27 the estimated tax payments exceed the final tax liability and statutory interest ultimately determined  
28 to be due, the Taxpayer is entitled to a refund or credit for the excess, provided the Taxpayer files a  
29 Federal Adjustments Report or claim for refund or credit of tax pursuant to [citation to State statute  
30 setting forth claim for refund requirements] no later than one year following the Final Determina-  
31 tion Date.

#### 32 **SECTION G. Claims for Refund or Credits of Tax Arising from Final Federal Adjustments Made** 33 **by the IRS or by Administrative Adjustment Request**

34 Except for negative Federal Adjustments required by federal law or regulations to be taken into ac-  
35 count by the partnership in the partnership return for the adjustment or other year. Final Federal  
36 Adjustments required to be reported for federal purposes under IRC section 6225(a)(2), a Taxpayer  
37 may file a claim for refund or credit of tax arising from Final Federal Adjustments made by the IRS

1 on or before the later of:

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

4 (2) One year from the date a Federal Adjustments Report prescribed in Sections B or C, as appli-  
5 cable, was due to the [State Agency], including any extensions pursuant to Section H.

6 The Federal Adjustments Report shall serve as the means for the Taxpayer, including a Partnership  
7 and its Tiered Partners, Direct Partners, and Indirect Partners, to report additional tax due, report a  
8 claim for refund or credit of tax, and make other adjustments (including to its net operating losses)  
9 resulting from adjustments to the Taxpayer's federal taxable income. Any refund granted to the part-  
10 nership under Section C is in lieu of state tax that may be owed to the partners.

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

12 (1) Unless otherwise agreed in writing by the Taxpayer and the [State Agency], any adjustments  
13 by the [State Agency] or by the Taxpayer made after the expiration of the [State's normal statute of  
14 limitations for assessment and refund] is limited to changes to the Taxpayer's tax liability arising  
15 from Federal Adjustments.

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

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

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

21 (3) Any extension granted under this Section H for filing the Federal Adjustments Report ex-  
22 tends the last day prescribed by law for assessing any additional tax arising from the adjustments to  
23 federal taxable income and the period for filing a claim for refund or credit of taxes pursuant to [ci-  
24 tation to State statute setting forth claim for refund requirements].

25 **SECTION I. Effective Date**

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

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