



TO: Members of Partnership Work Group and Uniformity Committee
FROM: MTC Staff
SUBJECT: Staff Report
DATE: April 3, 2018

NOTE: THIS REPORT IS PRELIMINARY AND IS PREPARED BY MTC STAFF FOR REVIEW AND DISCUSSION ONLY. AS OF THE DATE OF THIS REPORT, THE INTERESTED PARTIES HAVE NOT YET HAD A CHANCE TO REVIEW AND RESPOND TO THIS REPORT AND IT IS SUBJECT TO REVISION, IF NECESSARY.

On our March 15, 2018 call, we continued to solicit comments on the most recent version of the proposed model, and considered whether there need to be limitations on the partnership-pays election to avoid potential abuse. Since that call, Congress has passed the 2018 omnibus budget bill. That bill contained changes to the partnership audit provisions in the Bipartisan Budget Act of 2015 (BBA). This report does three things: (1) it summarizes staff analysis of the relevant federal changes and discusses specific recommendations related to those changes, (2) it summarizes some general comments about other edits to the proposed model, (3) it addresses the partnership-pays election and proposes an anti-abuse limitation.

OMNIBUS BILL CHANGES & TECHNICAL CORRECTIONS

This section is divided into two subsections: (1) a summary of two relevant omnibus bill changes, and (2) staff recommendations concerning those changes. (Also, Appendix A contains a copy of the omnibus bill changes, and Appendix B contains relevant sections from the Joint Committee on Taxation's report describing these changes.)

SUMMARY OF RELEVANT CHANGES FROM OMNIBUS BILL

NOTE: The changes do not appear to alter the approach taken by the IRS under proposed regulations which allows for multiple imputed underpayments to result from a single audit. The IRS is expected to use this flexibility to facilitate resolution of issues. For example, if there is a general adjustment increasing tax liability for all partners, and a separate reallocation adjustment affecting only a few partners, these adjustments could be treated as separate imputed underpayments, allowing the partnership to pay the liability for the former, and push out the latter.



TREATMENT OF POSITIVE AND NEGATIVE ADJUSTMENTS

BACKGROUND

A source of confusion in the BBA's partnership audit provisions is the use of the term *adjustment*. That term may be used to refer to any audit change in any amount. But it is also used more formally, as in "Proposed Partnership Adjustment" and the Final Partnership Adjustment." The term *adjustment* is also used when describing the calculation of the imputed underpayment and in describing the modification and the push-out processes. Specific adjustments may also be the subject of specific appeals or challenges.

But for purposes of the imputed underpayment, adjustments must be categorized. The imputed underpayment amount is designed to, effectively, overstate the tax that would be due if the partners reported the adjustments themselves. This, in turn, requires the IRS to separate different audit adjustments into different categories and limit the extent to which separate positive and negative adjustments can be netted.

IRS proposed regulations reflect this understanding. If audit adjustments (meaning changes in any amounts) fall within similar categories, then positive and negative adjustments may be netted. Examples include offsetting changes in the calculation of cost-of-goods-sold or positive and negative changes to the calculation of depreciation of various assets. But other audit adjustments, because they affect items that have varying tax characteristics or treatment, cannot be netted. As an example, an audit might reclassify a capital gain as ordinary income, creating both a positive and a negative adjustment that cannot be netted. But the negative adjustment to capital gains might be netted against other positive adjustments to capital gains (although this is up to the discretion of the IRS). Also, the positive and negative portions of reallocation adjustments are specifically not to be netted.

Assume an audit results in 10 changes to various tax-related amounts, some positive and some negative. If any negative changes cannot be netted against other positive changes, then there will be both positive and negative audit adjustments. Assume that after netting (or adding), there are three remaining adjustments—two positive and one negative. At this point, the two positive and one negative adjustment are treated differently for purposes of calculating the imputed underpayment. The positive adjustments are included in calculating one or two imputed underpayments. The negative adjustment, however (which may be the negative portion of a reallocation adjustment), would not be included in the computation of the imputed underpayment(s). Instead, if the partnership pays the imputed underpayment(s),



this negative adjustment would be passed through by the partnership to partners in the adjustment year.

But this treatment of positive and negative adjustments holds true only for the computation of the imputed underpayment and only if the partnership pays the imputed underpayment. If the adjustments are, instead, to be taken into account by a partner for purposes of modifying the imputed underpayment (e.g. by filing an amended return during the modification period), or if the adjustments are pushed out to the partners by the partnership, then both positive and negative adjustments are included in the partner-level calculations of tax.

RELEVANT CHANGES

- The omnibus bill changes clarify that adjustments that have different tax characteristics or treatment cannot be netted together in calculating an imputed underpayment. Items separately listed in IRC §702(a) and related regulations, in particular, are to be segregated and netted only against similar items to create separate, positive or negative, adjustments that cannot be further netted with other categories. Also, reallocation adjustments (and there may be multiple such adjustments in a single audit) are separate from each other and from other adjustments, and the positive and negative amounts are not netted.
- The changes also create a default rule that items that would tend to reduce tax (losses, deductions, etc.), but that might be limited under related tax rules when reported by direct and indirect partners, will be similarly limited to the extent they are netted against positive adjustments.
- The changes further clarify that the push-out process will not be limited to the positive adjustments used to calculate the imputed underpayment, but will, instead, include both adjustments that would increase and decrease the tax owed by the partners. The new term used to clarify this idea, and distinguish it from the term “adjustment, is “correction amount.”

NEW ALTERNATIVE “PULL-IN” PROCEDURES FOR MODIFICATIONS

BACKGROUND

The most substantial changes are made in to the modification process under IRC § 6225(c). Under the BBA provisions, if a reviewed year direct or indirect partner: (1) files amended returns, (2) takes into account all adjustments affecting the partner, as well as the effect of the adjustments on any tax attributes for subsequent years, and (3) pays the tax due, along with applicable interest and penalties, then the



partnership's imputed underpayment amount will be reduced accordingly. Also, there is no requirement for all reviewed year partners to participate, except in the case of reallocation adjustments.

CHANGES

- In addition to filing amended returns, the omnibus changes allow a new alternative procedure that can result in modifications—the “pull-in” option. Under the pull-in procedure, reviewed-year direct or indirect partners can simply provide information showing how the tax owed on the adjustments is computed, pay that tax, and make binding changes to their tax attributes for subsequent years. In this process, as in the filing of amended returns, not all partners need participate, unless it is to modify a reallocation adjustment.
- Under the pull-in process, the partnership or a third party can collect and report the information for participating partners and also make payments on their behalf. The effects of adjustments taken into account through modification will be binding in terms of the partners' tax attributes and failure to reflect the effects can be assessed as if it was an inconsistent treatment of a partnership item (math error).
- The changes seek to treat indirect partners the same as direct partners for purposes of modifications. So there is no requirement for all indirect partners to participate in filing amended returns or agreeing to be included in the pull-in procedure. The IRS can simply require the audited partnership to provide any information necessary, including the “chain of ownership” through the various tiers, to confirm that the modification sought should be made.
- The changes also give the IRS the ability to, essentially, apply a pull-in process to adjustments that would not result in an imputed underpayment (those that lower, rather than increase, tax), presumably including the offsetting portions of reallocation adjustments.

STAFF RECOMMENDATIONS

Based on this preliminary analysis, staff recommends considering two important changes to the model.

CALCULATION OF PARTNERSHIP PAYS AMOUNT

In some cases, there may be a significant difference in the approach taken by the IRS in calculating the imputed underpayment and treating negative adjustments, and



the approach taken in the proposed model to compute the state-level partnership liability under the partnership pays election. As noted above, when the partnership pays at the federal level, positive and negative adjustments that cannot be netted will be treated differently. The positive adjustments (including, but not limited to, positive reallocation amounts) will be included in the imputed underpayment calculation. The negative adjustments will be passed through to the adjustment year partners in the partnership's return filed in that year.

In its discussions, the group previously considered whether to treat negative *reallocation* adjustments differently for state purposes, netting them against positive adjustments. But this created two issues. First, we recognized that a reallocation adjustment would likely be made only when it would affect the total amount of tax paid by the partners (e.g. the allocations are made for that purpose but do not have substantial economic effect). Netting the adjustments to compute the partnership-level liability would under, rather than over-state the tax due. Second, there is potential for double-counting the negative (tax-reducing) amounts because, if the partnership also pays the federal imputed underpayment, the negative amounts will be passed through in the adjustment year on the federal return, to which states generally conform. Therefore, the model instead took the same approach as the calculation of the federal imputed underpayment and included the positive amounts of the reallocation adjustments, but not the negative amounts.

However, it now appears likely, based on the clarifications in the omnibus bill, that there will be other kinds of significant negative adjustments that cannot be netted and will be subject to the same pass-through treatment in the adjustment year partnership return, assuming the partnership pays the federal imputed underpayment. Note also that our proposed model uses the terms "Federal Adjustment" (and "Final Federal Adjustment"). The definition of those terms specifies that the Federal Adjustments may be positive (increasing tax) or negative (decreasing tax). So, unless the calculation of the partnership pays amount under the model specifies that only positive Final Federal Adjustments are included (or that negative Final Federal Adjustments are excluded) the calculation will include negative amounts, other than negative reallocation amounts.

On the other hand, unlike reallocation adjustments, these other negative adjustments may not have the same effect on state taxes, requiring them not to be netted. For example, states may not tax capital gains and ordinary income at different rates. But there may also be less incentive for the partnership to push out these negative adjustments since they will not have significantly different effects on the partners, unlike reallocation adjustments. This means that the potential for double-counting



their effects remains (since they will also pass through in the adjustment year return). Whether the partnership does or does not push out any negative adjustments at the federal level is something that will be known by the time it makes the state-level election. Including (netting) these negative non-reallocation adjustments against positive adjustments in the state partnership-pays amount would appear to be an acceptable approach if the adjustments were pushed out at the federal level. Changes that reflect this recommendation have been included in the edits to the model in Appendix C to this report under Section C(3)(c)(iii).

REVIEW THE EFFECT OF THE ALTERNATIVE PULL-IN PROCESS

The omnibus bill changes specify that modifications may be made, reducing the ultimate imputed underpayment, through a process that does not require the filing of an amended return by partners. At a minimum, this requires certain edits to the proposed model. But it may also require states to consider other related changes to their laws. Some proposed changes to the model are included in the changes discussed in the following section and in the Appendix C to this report.

But it is not clear that the model or existing state law will fully accommodate the idea of having the partnership or a third party report and pay on behalf of partners as is anticipated at the federal level. In any case, if this federal process triggers a state filing duty, as it should, then the states will need to provide a corresponding process, even if it is simply requiring partners to file amended state returns. But states may want to consider a process similar to the federal process.

SUMMARY OF COMMENTS/EDITS TO PROPOSED MODEL

In addition to the suggested changes discussed above, other edits were made to the proposed model, most of which have also been annotated with comments in the version included with this report in Appendix C. This version of the model reflects (accepts) all the changes made by the Interested Parties in the prior version discussed by the group and retains the comments that were annotated in that version. Also, this version contains certain non-substantive conforming changes that are not separately redlined.

One comment is worth mentioning. The model anticipates use of a Federal Adjustments Report, containing certain unspecified information, and also anticipates that the partnership making an election to pay will provide “partner information.” It may be worth further discussion of whether the exact information should be specified.



PARTNERSHIP PAYS ANTI-ABUSE LIMITATION

BACKGROUND

As the group is aware, having the partnership pay creates the possibility that partners who would otherwise pay tax to their residency state on partnership income not taxed elsewhere will, instead, pay less tax, or no tax, in that state, even if they do not pay more tax elsewhere. Moreover, under the model, the partnership-pays election is not dependent on whether the partnership pays at the federal level, or in any other state. So a partnership would not have to take on the entity-level liability in all states if it does so in one state.

This is particularly concerning where states have adopted a rule or practice of treating certain types of partnership income, generally passive investment income, as allocable to the partner's domicile or state of residency. Unless the audited partnership can look through to the residency status of the reviewed year partners, both direct and indirect, it will be impossible for the tax to be sourced to the same states it would have been had the partners themselves reported and paid it. Assume, for example, that the audited partnership has several pass-through partners (tiers) between it and its individual partners, who are all residents in State A. Also assume that the audited partnership's operations are in State B. Even if both A and B impose equal taxes and treat passive investment income as sourced to a partner's state of residency, the partners and the partnership may avoid any additional tax. The audited partnership may simply make the partnership pays election in State A and not in State B. The partners would owe no taxes in State B, and the partnership would owe no taxes (at least on a traditional apportioned basis) in State A.

The Interested Parties have proposed a method of calculating the state-level partnership-pays amount which would allocate 100% of the distributive share of adjustments to the state for partners who are resident in the state, but only if those partners are direct partners. This would not resolve the example above, however, because none of the individual partners are direct partners of the audited partnership.

It appears, however, that in many cases, by the time the partnership has completed the federal audit, it will have access to a substantial amount of information about some or all indirect partners. Therefore, one way to potentially avoid abuse is to require that partnership to use the available information to determine who should be treated as a resident partner for purposes of determining what portions of adjustments should be allocated 100% to the state. This idea is reflected in a change



to the partnership-pays election in the edits in Appendix C. An alternative would be to use that same available information to source passive investment income based on residency alone—so that if the partnership shows what share of adjustments is allocated to non-resident direct and indirect partners, that portion would be excluded from the state partnership-level liability, rather than included on an apportioned basis.

1 utility is generated, transmitted, distrib-
2 uted, and consumed in the same State, the
3 State agency of such State with the au-
4 thority to regulate electric utilities.”.

5 (c) EFFECTIVE DATE.—The amendments made by
6 this section shall take effect as if included in section 319
7 of the American Jobs Creation Act of 2004.

8 **TITLE II—TECHNICAL CORREC-**
9 **TIONS RELATED TO PART-**
10 **NERSHIP AUDIT RULES**

11 **SEC. 201. SCOPE OF ADJUSTMENTS SUBJECT TO PARTNER-**
12 **SHIP AUDIT RULES.**

13 (a) IN GENERAL.—Section 6241(2) is amended to
14 read as follows:

15 “(2) PARTNERSHIP ADJUSTMENT.—

16 “(A) IN GENERAL.—The term ‘partnership
17 adjustment’ means any adjustment to a part-
18 nership-related item.

19 “(B) PARTNERSHIP-RELATED ITEM.—The
20 term ‘partnership-related item’ means—

21 “(i) any item or amount with respect
22 to the partnership (without regard to
23 whether or not such item or amount ap-
24 pears on the partnership’s return and in-
25 cluding an imputed underpayment and any

1 item or amount relating to any transaction
2 with, basis in, or liability of, the partner-
3 ship) which is relevant (determined without
4 regard to this subchapter) in determining
5 the tax liability of any person under chap-
6 ter 1, and

7 “(ii) any partner’s distributive share
8 of any item or amount described in clause
9 (i).”.

10 (b) COORDINATION WITH OTHER CHAPTERS.—

11 (1) IN GENERAL.—Section 6241 is amended by
12 adding at the end the following new paragraph:

13 “(9) COORDINATION WITH OTHER CHAPTERS.—

14 “(A) IN GENERAL.—This subchapter shall
15 not apply with respect to any tax imposed (in-
16 cluding any amount required to be deducted or
17 withheld) under chapter 2, 2A, 3, or 4, except
18 that any partnership adjustment determined
19 under this subchapter for purposes of chapter 1
20 shall be taken into account for purposes of de-
21 termining any such tax to the extent that such
22 adjustment is relevant to such determination.

23 “(B) TIMING OF WITHHOLDING.—In the
24 case of any tax imposed (including any amount
25 required to be deducted or withheld) under

1 chapter 3 or 4, which is determined with re-
2 spect to an adjustment described in subpara-
3 graph (A), such tax—

4 “(i) shall be so determined with re-
5 spect to the reviewed year, and

6 “(ii) shall be so imposed (or so re-
7 quired to be deducted or withheld) with re-
8 spect to the adjustment year.

9 “(C) STATUTE OF LIMITATION ON ASSESS-
10 MENT.—For special rule with respect to limita-
11 tion on assessment of taxes under chapter 2 or
12 2A which are attributable to any partnership
13 adjustment, see section 6501(c)(12).”.

14 (2) SPECIAL RULE.—Section 6501(c) is amend-
15 ed by adding at the end the following new para-
16 graph:

17 “(12) CERTAIN TAXES ATTRIBUTABLE TO
18 PARTNERSHIP ADJUSTMENTS.—In the case of any
19 partnership adjustment determined under sub-
20 chapter C of chapter 63, the period for assessment
21 of any tax imposed under chapter 2 or 2A which is
22 attributable to such adjustment shall not expire be-
23 fore the date that is 1 year after—

24 “(A) in the case of an adjustment pursu-
25 ant to the decision of a court in a proceeding

1 brought under section 6234, such decision be-
2 comes final, or

3 “(B) in any other case, 90 days after the
4 date on which the notice of the final partner-
5 ship adjustment is mailed under section 6231.”.

6 (c) CONFORMING AMENDMENTS.—

7 (1) Section 6211(c) is amended to read as fol-
8 lows:

9 “(c) COORDINATION WITH SUBCHAPTER C.—In de-
10 termining the amount of any deficiency for purposes of
11 this subchapter, adjustments to partnership-related items
12 shall be made only as provided in subchapter C.”.

13 (2) Section 6221(a) is amended to read as fol-
14 lows:

15 “(a) IN GENERAL.—Any adjustment to a partner-
16 ship-related item shall be determined, and any tax attrib-
17 utable thereto shall be assessed and collected, and the ap-
18 plicability of any penalty, addition to tax, or additional
19 amount which relates to an adjustment to any such item
20 shall be determined, at the partnership level, except to the
21 extent otherwise provided in this subchapter.”.

22 (3) Section 6222(a) is amended to read as fol-
23 lows:

24 “(a) IN GENERAL.—A partner shall, on the partner’s
25 return, treat any partnership-related item in a manner

1 which is consistent with the treatment of such item on
2 the partnership return.”.

3 (4) Section 6226(a)(2) is amended by striking
4 “any adjustment to income, gain, loss, deduction, or
5 credit” and inserting “any adjustment to a partner-
6 ship-related item”.

7 (5) Section 6227(a) is amended by striking
8 “items of income, gain, loss, deduction, or credit of
9 the partnership” and inserting “partnership-related
10 items”.

11 (6) Section 6231(a)(1) is amended by striking
12 “any item of income, gain, loss, deduction, or credit
13 of a partnership for a partnership taxable year” and
14 inserting “any partnership-related item for any part-
15 nership taxable year”.

16 (7) Section 6234(c) is amended by striking “all
17 items of income, gain, loss, deduction, or credit of
18 the partnership” and inserting “all partnership-re-
19 lated items”.

20 (8) Section 7485(b) is amended by striking
21 “partnership items” and inserting “partnership-re-
22 lated items (as defined in section 6241)”.

23 **SEC. 202. DETERMINATION OF IMPUTED UNDERPAYMENTS.**

24 (a) IN GENERAL.—Section 6225(b) is amended to
25 read as follows:

1 “(b) DETERMINATION OF IMPUTED UNDERPAY-
2 MENTS.—For purposes of this subchapter—

3 “(1) IN GENERAL.—Except as otherwise pro-
4 vided in this section, any imputed underpayment
5 with respect to any reviewed year shall be deter-
6 mined by the Secretary by—

7 “(A) appropriately netting all partnership
8 adjustments with respect to such reviewed year,
9 and

10 “(B) applying the highest rate of tax in ef-
11 fect for the reviewed year under section 1 or
12 11.

13 “(2) ADJUSTMENTS TO DISTRIBUTIVE SHARES
14 OF PARTNERS NOT NETTED.—In the case of any ad-
15 justment which reallocates the distributive share of
16 any item from one partner to another, such adjust-
17 ment shall be taken into account by disregarding so
18 much of such adjustment as results in a decrease in
19 the amount of the imputed underpayment.

20 “(3) ADJUSTMENTS SEPARATELY NETTED BY
21 CATEGORY.—For purposes of paragraph (1)(A),
22 partnership adjustments for any reviewed year shall
23 first be separately determined (and netted as appro-
24 priate) within each category of items that are re-

1 quired to be taken into account separately under
2 section 702(a) or other provision of this title.

3 “(4) LIMITATION ON ADJUSTMENTS THAT MAY
4 BE TAKEN INTO ACCOUNT.—If any adjustment
5 would (but for this paragraph)—

6 “(A) result in a decrease in the amount of
7 the imputed underpayment, and

8 “(B) could be subject to any additional
9 limitation under the provisions of this title (or
10 not allowed, in whole or in part, against ordi-
11 nary income) if such adjustment were taken
12 into account by any person,

13 such adjustment shall not be taken into account
14 under paragraph (1)(A) except to the extent other-
15 wise provided by the Secretary.”.

16 (b) MODIFICATIONS OF IMPUTED UNDERPAY-
17 MENTS.—

18 (1) Section 6225(c)(3) is amended by striking
19 “without regard to the portion thereof” and insert-
20 ing “without regard to the portion of the adjust-
21 ment”.

22 (2) Section 6225(c)(4)(A) is amended by strik-
23 ing “with respect to any portion of the imputed un-
24 derpayment” and inserting “with respect to any por-
25 tion of the adjustment”.

1 (3) Section 6225(e)(5)(A)(i) is amended by
2 striking “without regard to the portion thereof” and
3 inserting “without regard to the portion of the ad-
4 justment”.

5 (c) CONFORMING AMENDMENTS.—

6 (1) Section 6225(a) is amended to read as fol-
7 lows:

8 “(a) IN GENERAL.—In the case of any adjustments
9 by the Secretary to any partnership-related items with re-
10 spect to any reviewed year of a partnership—

11 “(1) if such adjustments result in an imputed
12 underpayment, the partnership shall pay an amount
13 equal to such imputed underpayment in the adjust-
14 ment year as provided in section 6232, and

15 “(2) if such adjustments do not result in an im-
16 puted underpayment, such adjustments shall be
17 taken into account by the partnership in the adjust-
18 ment year.”.

19 (2) Section 6225(e) is amended by adding at
20 the end the following new paragraph:

21 “(9) MODIFICATION OF ADJUSTMENTS NOT RE-
22 SULTING IN AN IMPUTED UNDERPAYMENT.—The
23 Secretary shall establish procedures under which the
24 adjustments described in subsection (a)(2) may be

1 modified in such manner as the Secretary deter-
2 mines appropriate.”.

3 **SEC. 203. ALTERNATIVE PROCEDURE TO FILING AMENDED**
4 **RETURNS FOR PURPOSES OF MODIFYING IM-**
5 **PUTED UNDERPAYMENT.**

6 (a) IN GENERAL.—Section 6225(c)(2) is amended to
7 read as follows:

8 “(2) PROCEDURES FOR PARTNERS TO TAKE AD-
9 JUSTMENTS INTO ACCOUNT.—

10 “(A) AMENDED RETURNS OF PARTNERS.—

11 Such procedures shall provide that if—

12 “(i) one or more partners file returns
13 for the taxable year of the partners which
14 includes the end of the reviewed year of
15 the partnership (and for any taxable year
16 with respect to which any tax attribute is
17 affected by reason of any adjustment re-
18 ferred to in clause (ii)),

19 “(ii) such returns take into account
20 all adjustments under subsection (a) prop-
21 erly allocable to such partners (and the ef-
22 fect of such adjustments on any tax at-
23 tributes), and

24 “(iii) payment of any tax due is in-
25 cluded with such returns,

1 then the imputed underpayment amount shall
2 be determined without regard to the portion of
3 the adjustments so taken into account.

4 “(B) ALTERNATIVE PROCEDURE TO FIL-
5 ING AMENDED RETURNS.—Such procedures
6 shall provide that, with respect to any partner
7 referred to in subparagraph (A), the require-
8 ments of subparagraph (A) shall be treated as
9 satisfied with respect to adjustments properly
10 allocable to such partner if, in lieu of filing the
11 returns described in such subparagraph—

12 “(i) the amounts described in sub-
13 paragraph (A)(iii) are paid by the partner,

14 “(ii) the partner agrees to take into
15 account, in the form and manner pre-
16 scribed by the Secretary, the adjustments
17 to the tax attributes of such partner re-
18 ferred to in subparagraph (A)(ii), and

19 “(iii) such partner provides, in the
20 form and manner specified by the Sec-
21 retary (including, if the Secretary so speci-
22 fies, in the same form as on an amended
23 return), such information as the Secretary
24 may require to carry out this subpara-
25 graph.

1 “(C) REALLOCATION OF DISTRIBUTIVE
2 SHARE.—In the case of any adjustment which
3 reallocates the distributive share of any item
4 from one partner to another, this paragraph
5 shall apply with respect to any such partner
6 only if the requirements of subparagraph (A) or
7 (B) are satisfied with respect to all partners af-
8 fected by such adjustment.

9 “(D) APPLICATION OF STATUTE OF LIM-
10 TATIONS.—In the case of adjustments referred
11 to in subparagraph (A)(ii), sections 6501 and
12 6511 shall not apply with respect to any return
13 filed for purposes of subparagraph (A)(i) or any
14 amount paid under subparagraph (A)(iii) or
15 (B)(i).

16 “(E) ADJUSTMENTS TO TAX ATTRIBUTES
17 BINDING FOR AFFECTED TAXABLE YEARS OF
18 PARTNER.—The adjustments to the tax at-
19 tributes of any partner provided for in subpara-
20 graph (A)(ii) or (B)(ii) shall be binding with re-
21 spect to the taxable year of the partner which
22 includes the end of the reviewed year of the
23 partnership and any taxable years for which
24 any tax attribute is affected by such adjust-
25 ment. Any failure to so treat any such tax at-

1 tribute shall be treated for purposes of this title
2 in the same manner as a failure to treat a part-
3 nership-related item in a manner which is con-
4 sistent with the treatment of such item on the
5 partnership return within the meaning of sec-
6 tion 6222.

7 “(F) APPLICATION TO PARTNERSHIPS AND
8 S CORPORATIONS IN TIERED STRUCTURES.—

9 “(i) IN GENERAL.—In the case of any
10 partnership any partner of which is a part-
11 nership, subparagraph (A) or (B) may
12 apply with respect to any partner (here-
13 after in this subparagraph referred to as
14 the ‘relevant partner’) in the chain of own-
15 ership of such partnerships if—

16 “(I) such information as the Sec-
17 retary may require is furnished to the
18 Secretary for purposes of carrying out
19 this paragraph with respect to such
20 partnerships (including any informa-
21 tion the Secretary may require with
22 respect to any chain of ownership of
23 the relevant partner), and

24 “(II) to such extent as the Sec-
25 retary may require, each partnership

1 in the chain of ownership between the
2 relevant partner and the audited part-
3 nership satisfies the requirements of
4 subparagraph (A) or (B).

5 “(ii) TREATMENT OF S CORPORA-
6 TIONS.—For purposes of clause (i), an S
7 corporation and its shareholders shall be
8 treated in the same manner as a partner-
9 ship and its partners.”.

10 (b) CONFORMING AMENDMENT.—Section 6201(a)(1)
11 is amended by inserting “(or payments under section
12 6225(c)(2)(B)(i))” after “returns or lists”.

13 **SEC. 204. TREATMENT OF PASSTHROUGH PARTNERS IN**
14 **TIERED STRUCTURES.**

15 (a) IN GENERAL.—Section 6226(b) is amended by
16 adding at the end the following new paragraph:

17 “(4) TREATMENT OF PARTNERSHIPS AND S
18 CORPORATIONS IN TIERED STRUCTURES.—

19 “(A) IN GENERAL.—If a partner which re-
20 ceives a statement under subsection (a)(2) is a
21 partnership or an S corporation, such partner
22 shall, with respect to the partner’s share of the
23 adjustment—

24 “(i) file with the Secretary a partner-
25 ship adjustment tracking report which in-

1 cludes such information as the Secretary
2 may require, and

3 “(ii)(I) furnish statements under rules
4 similar to the rules of subsection (a)(2), or

5 “(II) if no such statements are fur-
6 nished, compute and pay an imputed un-
7 derpayment under rules similar to the
8 rules of section 6225 (other than para-
9 graphs (2), (7), and (9) of subsection (c)
10 thereof).

11 “(B) DUE DATE.—For purposes of sub-
12 paragraph (A), with respect to a partner’s
13 share of the adjustment, the partnership adjust-
14 ment tracking report shall be filed, and the im-
15 puted underpayment shall be paid or state-
16 ments shall be furnished, not later than the due
17 date for the return for the adjustment year of
18 the audited partnership.

19 “(C) PARTNERSHIP PAYMENT OF TAX IF
20 ELECTED OUT OF SUBCHAPTER.—In the case of
21 a partnership which has elected the application
22 of section 6221(b) with respect to the taxable
23 year of the partnership which includes the end
24 of the reviewed year of the audited partnership,

1 this paragraph shall apply notwithstanding such
2 election.

3 “(D) AUDITED PARTNERSHIP.—For pur-
4 poses of this paragraph, the term ‘audited part-
5 nership’ means, with respect to any partner de-
6 scribed in subparagraph (A), the partnership in
7 the chain of ownership originally electing the
8 application of this section.

9 “(E) TREATMENT OF TRUSTS.—The Sec-
10 retary shall prescribe such rules as may be nec-
11 essary with respect to trusts which receive a
12 statement under subsection (a)(2).”.

13 (b) CONFORMING AMENDMENTS.—

14 (1) Section 6226(b)(1) is amended by striking
15 “Each partner’s” and inserting “Except as provided
16 in paragraph (4), each partner’s”.

17 (2) Section 6226(c)(2) is amended by inserting
18 “or which is described in subsection
19 (b)(4)(A)(ii)(I),” after “is elected,”.

20 **SEC. 205. TREATMENT OF FAILURE OF PARTNERSHIP TO**
21 **PAY IMPUTED UNDERPAYMENT.**

22 (a) IN GENERAL.—Section 6232 is amended by add-
23 ing at the end the following new subsection:

24 “(f) FAILURE TO PAY IMPUTED UNDERPAYMENT.—

1 “(1) IN GENERAL.—If any amount of any im-
2 puted underpayment to which section 6225 applies
3 or any specified similar amount (or any interest or
4 penalties with respect to any such amount) has not
5 been paid by the date which is 10 days after the
6 date on which the Secretary provides notice and de-
7 mand for such payment—

8 “(A) section 6621(a)(2)(B) shall be ap-
9 plied by substituting ‘5 percentage points’ for ‘3
10 percentage points’ with respect to such amount,
11 and

12 “(B) the Secretary may assess upon each
13 partner of the partnership (determined as of
14 the close of the adjustment year or, if the part-
15 nership has ceased to exist as of such time, the
16 former partners of the partnership as deter-
17 mined for purposes of section 6241(7)) a tax
18 equal to such partner’s proportionate share of
19 such amount (including any such interest or
20 penalties, determined after application of sub-
21 paragraph (A)).

22 “(2) SPECIFIED SIMILAR AMOUNT.—For pur-
23 poses of this subsection, the term ‘specified similar
24 amount’ means—

1 “(A) the amount described in subclause
2 (II) of section 6226(b)(4)(A)(ii) (including any
3 failure to satisfy the requirement of subclause
4 (I) of such section which is treated as a failure
5 to pay such amount under section 6651(i)), and

6 “(B) any amount assessed under para-
7 graph (1)(B) upon a partner which is a part-
8 nership.

9 “(3) PROPORTIONATE SHARE.—For purposes of
10 paragraph (1), a partner’s proportionate share is
11 such percentage as the Secretary may determine on
12 the basis of such partner’s distributive share. The
13 Secretary shall make determinations under the pre-
14 ceding sentence such that the aggregate propor-
15 tionate shares so determined total 100 percent.

16 “(4) COORDINATION WITH PARTNERSHIP LI-
17 ABILITY.—The liability of the partnership for any
18 amount with respect to which a partner is made lia-
19 ble under paragraph (1) shall be reduced upon pay-
20 ment by the partner of such amount. Paragraph
21 (1)(B) shall not apply with respect to any amount
22 after the date on which such amount is paid by the
23 partnership.

24 “(5) S CORPORATIONS.—For purposes of this
25 subsection, an S corporation and its shareholders

1 shall be treated in the same manner as a partner-
2 ship and its partners.

3 “(6) RULES RELATED TO ASSESSMENT AND
4 COLLECTION.—

5 “(A) DEFICIENCY PROCEDURES NOT AP-
6 PPLICABLE.—Subchapter B shall not apply to
7 any assessment or collection under this para-
8 graph.

9 “(B) LIMITATION ON ASSESSMENT.—Ex-
10 cept as otherwise provided in this subtitle, no
11 assessment may be made (or proceeding in
12 court begun without assessment) with respect
13 to any partner with respect to an amount under
14 paragraph (1) after the date which is 2 years
15 after the date on which the Secretary provides
16 the notice and demand referred to in paragraph
17 (1) with respect to such amount.”.

18 (b) CONFORMING AMENDMENT.—Section
19 6501(c)(4)(A) is amended by striking “in this section”.

20 **SEC. 206. OTHER TECHNICAL CORRECTIONS RELATED TO**
21 **PARTNERSHIP AUDIT RULES.**

22 (a) LIMITATION ON AMENDMENT OF STATEMENTS
23 FURNISHED TO PARTNERS NOT APPLICABLE TO PART-
24 NERSHIPS ELECTING OUT OF PARTNERSHIP AUDIT
25 RULES.—Section 6031(b) is amended by striking the last

1 sentence and inserting the following: “Information re-
2 quired to be furnished by the partnership under this sub-
3 section may not be amended after the due date of the re-
4 turn under subsection (a) to which such information re-
5 lates, except—

6 “(1) in the case of a partnership which has
7 elected the application of section 6221(b) for the
8 taxable year,

9 “(2) as provided in the procedures under sec-
10 tion 6225(c),

11 “(3) with respect to statements under section
12 6226, or

13 “(4) as otherwise provided by the Secretary.”.

14 (b) ADMINISTRATIVE ADJUSTMENT REQUEST AND
15 PARTNERSHIP ADJUSTMENT TRACKING REPORT NOT
16 TREATED AS AMENDED RETURN FOR PURPOSES OF
17 MODIFICATION OF IMPUTED UNDERPAYMENTS.—Section
18 6225(c)(2), as amended by the preceding provisions of this
19 Act, is amended by adding at the end the following new
20 subparagraph:

21 “(F) ADJUSTMENTS NOT TREATED AS
22 AMENDED RETURN.—An administrative adjust-
23 ment request under section 6227 and a partner-
24 ship adjustment tracking report under section

1 6226(b)(4)(A) shall not be treated as a return
2 for purposes of this paragraph.”.

3 (c) AUTHORITY TO REQUIRE E-FILING OF MATE-
4 RIALS IN CONNECTION WITH MODIFICATION OF IMPUTED
5 UNDERPAYMENTS, ETC.—Section 6241, as amended by
6 the preceding provisions of this Act, is amended by adding
7 at the end the following new paragraph:

8 “(10) AUTHORITY TO REQUIRE ELECTRONIC
9 FILING.—Notwithstanding section 6011(e), the Sec-
10 retary may require that anything required to be filed
11 or submitted under section 6225(c), or to be fur-
12 nished to or filed with the Secretary under section
13 6226, be so filed, submitted, or furnished by mag-
14 netic media or in other machine-readable form.”.

15 (d) CLARIFICATION OF ASSESSMENT AUTHORITY.—
16 Section 6226(a) is amended by inserting “(and no assess-
17 ment of tax, levy, or proceeding in any court for the collec-
18 tion of such underpayment shall be made against such
19 partnership)” after “section 6225 shall not apply with re-
20 spect to such underpayment”.

21 (e) TREATMENT OF PARTNERSHIP ADJUSTMENTS
22 THAT RESULT IN DECREASE IN TAX IN CASE OF ELEC-
23 TION TO PUSH OUT ADJUSTMENTS.—Section 6226(b) is
24 amended—

1 (1) by striking “increased” in paragraph (1)
2 and inserting “adjusted”,

3 (2) by striking “adjustment amounts” each
4 place it appears in paragraphs (1) and (2) and in-
5 serting “correction amounts”,

6 (3) by striking “increase” each place it appears
7 in subparagraphs (A) and (B) of paragraph (2) and
8 inserting “increase or decrease”,

9 (4) by striking “plus” at the end of paragraph
10 (2)(A) and inserting “and”, and

11 (5) by striking “ADJUSTMENT AMOUNTS” in
12 the heading of paragraph (2) and inserting “COR-
13 RECTION AMOUNTS”.

14 (f) COORDINATION OF STATUTE OF LIMITATION ON
15 FILING ADMINISTRATION ADJUSTMENT REQUEST WITH
16 ADJUSTMENTS RELATED TO FOREIGN TAX CREDITS.—
17 Section 6227 is amended by adding at the end the fol-
18 lowing new subsection:

19 “(d) COORDINATION WITH ADJUSTMENTS RELATED
20 TO FOREIGN TAX CREDITS.—The Secretary shall issue
21 regulations or other guidance which provide for the proper
22 coordination of this section and section 905(c).”.

23 (g) CLARIFICATION OF ASSESSMENT OF IMPUTED
24 UNDERPAYMENTS.—

1 (1) IN GENERAL.—Section 6232(a) is amended
2 by striking “except that in the case of” and all that
3 follows and inserting the following: “except that—

4 “(1) subchapter B of chapter 63 shall not
5 apply, and

6 “(2) in the case of an administrative adjust-
7 ment request to which section 6227(b)(1) applies,
8 the underpayment shall be paid and may be assessed
9 when the request is filed.”.

10 (2) CONFORMING AMENDMENT.—Section
11 6232(b) is amended—

12 (A) by striking “assessment of a defi-
13 ciency” and inserting “assessment of an im-
14 puted underpayment”, and

15 (B) by adding at the end the following new
16 flush matter:

17 “The preceding sentence shall not apply in the case of a
18 specified similar amount (as defined in subsection
19 (f)(2)).”.

20 (h) TIME LIMITATION FOR NOTICE OF PROPOSED
21 ADJUSTMENT.—

22 (1) IN GENERAL.—Section 6231 is amended by
23 redesignating subsections (b) and (c) as subsections
24 (c) and (d), respectively, and by inserting after sub-
25 section (a) the following new subsection:

1 “(b) TIMING OF NOTICES.—

2 “(1) NOTICE OF PROPOSED PARTNERSHIP AD-
3 JUSTMENT.—Any notice of a proposed partnership
4 adjustment shall not be mailed later than the date
5 determined under section 6235 (determined without
6 regard to paragraphs (2) and (3) of subsection (a)
7 thereof).

8 “(2) NOTICE OF FINAL PARTNERSHIP ADJUST-
9 MENT.—

10 “(A) IN GENERAL.—Except to the extent
11 that the partnership elects to waive the applica-
12 tion of this subparagraph, any notice of a final
13 partnership adjustment shall not be mailed ear-
14 lier than 270 days after the date on which the
15 notice of the proposed partnership adjustment
16 is mailed.

17 “(B) STATUTE OF LIMITATIONS ON AD-
18 JUSTMENT.—For the period of limitations on
19 making adjustments, see section 6235.”.

20 (2) CONFORMING AMENDMENT.—Section
21 6231(a) is amended by striking “Any notice of a
22 final partnership adjustment” and all that follows
23 through “Such notices” and inserting “Any notice of
24 a final partnership adjustment”.

1 (i) DEPOSIT TO SUSPEND INTEREST ON IMPUTED
2 UNDERPAYMENT.—Section 6233 is amended by adding at
3 the end the following new subsection:

4 “(c) DEPOSIT TO SUSPEND INTEREST.—For rules al-
5 lowing deposits to suspend running of interest on potential
6 underpayments, see section 6603.”.

7 (j) DEPOSIT TO MEET JURISDICTIONAL REQUIRE-
8 MENT.—The first sentence of section 6234(b) is amended
9 by striking “the amount of the imputed underpayment (as
10 of the date of the filing of the petition)” and inserting
11 “the amount of (as of the date of the filing of the petition)
12 the imputed underpayment, penalties, additions to tax,
13 and additional amounts with respect to such imputed un-
14 derpayment”.

15 (k) CORRECTIONS RELATED TO PERIOD OF LIMITA-
16 TION ON MAKING ADJUSTMENTS.—

17 (1) Section 6235(a) is amended—

18 (A) by inserting “or section 905(c)” after
19 “Except as otherwise provided in this section”,
20 and

21 (B) by striking “subpart” and inserting
22 “subchapter”.

23 (2) Section 6235(a)(3) is amended by striking
24 “section 6225(c)(7)” and inserting “section
25 6225(c)(7)”.

1 (3) Section 6235(c)(2) is amended by striking
2 “section 6501(e)(1)(A)” and inserting “subpara-
3 graph (A) or (C) of section 6501(e)(1)”.

4 (4) Section 6235(e) is amended by adding at
5 the end the following new subparagraphs:

6 “(5) INFORMATION REQUIRED TO BE RE-
7 PORTED.—In the case of a partnership that is re-
8 quired to report any information described in section
9 6501(e)(8), the time for making any adjustment
10 under this subchapter with respect to any tax re-
11 turn, event, or period to which such information re-
12 lates shall not expire before the date that is deter-
13 mined under section 6501(e)(8).

14 “(6) LISTED TRANSACTIONS.—If a partnership
15 fails to include on any return or statement any in-
16 formation with respect to a listed transaction as de-
17 scribed in section 6501(e)(10), the time for making
18 any adjustment under this subchapter with respect
19 to such transaction shall not expire before the date
20 that is determined under section 6501(e)(10).”.

21 (5) Section 6235 is amended by striking sub-
22 section (d).

23 (1) TREATMENT OF SPECIAL ENFORCEMENT MAT-
24 TERS.—Section 6241, as amended by the preceding provi-

1 sions of this Act, is amended by adding at the end the
2 following new paragraph:

3 “(11) TREATMENT OF SPECIAL ENFORCEMENT
4 MATTERS.—

5 “(A) IN GENERAL.—In the case of part-
6 nership-related items which involve special en-
7 forcement matters, the Secretary may prescribe
8 regulations pursuant to which—

9 “(i) this subchapter (or any portion
10 thereof) does not apply to such items, and

11 “(ii) such items are subject to such
12 special rules (including rules related to as-
13 sessment and collection) as the Secretary
14 determines to be necessary for the effective
15 and efficient enforcement of this title.

16 “(B) SPECIAL ENFORCEMENT MATTERS.—
17 For purposes of subparagraph (A), the term
18 ‘special enforcement matters’ means—

19 “(i) failure to comply with the re-
20 quirements of section 6226(b)(4)(A)(ii),

21 “(ii) assessments under section 6851
22 (relating to termination assessments of in-
23 come tax) or section 6861 (relating to
24 jeopardy assessments of income, estate,
25 gift, and certain excise taxes),

1 “(iii) criminal investigations,
2 “(iv) indirect methods of proof of in-
3 come,
4 “(v) foreign partners or partnerships,
5 and
6 “(vi) other matters that the Secretary
7 determines by regulation present special
8 enforcement considerations.”.

9 (m) UNITED STATES SHAREHOLDERS AND CERTAIN
10 OTHER PERSONS TREATED AS PARTNERS.—Section
11 6241, as amended by the preceding provisions of this Act,
12 is amended by adding at the end the following new para-
13 graph:

14 “(12) UNITED STATES SHAREHOLDERS AND
15 CERTAIN OTHER PERSONS TREATED AS PART-
16 NERS.—

17 “(A) IN GENERAL.—Except as otherwise
18 provided by the Secretary, in the case of any
19 controlled foreign corporation (as defined in
20 section 957 or 953(c)(1)) which is a partner of
21 a partnership, each United States shareholder
22 (as defined in section 951(b) or 953(c)(1)) with
23 respect to such controlled foreign corporation
24 shall be treated for purposes of this subchapter
25 as a partner of such partnership. For purposes

1 of the preceding sentence, any distributive
2 share of any such United States shareholder
3 with respect to such partnership shall, except as
4 otherwise provided by the Secretary, be equal to
5 such United States shareholder's pro rata share
6 with respect to such controlled foreign corpora-
7 tion (determined under rules similar to the
8 rules of section 951(a)(2)).

9 “(B) PASSIVE FOREIGN INVESTMENT COM-
10 PANIES.—For purposes of subparagraph (A), in
11 the case of a passive foreign investment com-
12 pany (as defined in section 1297), each tax-
13 payer that makes an election under section
14 1295 with respect to such company shall be
15 treated in the same manner as United States
16 shareholders under subparagraph (A), except
17 that such taxpayer's pro rata share with respect
18 to the passive foreign investment company shall
19 be determined under rules similar to the rules
20 of section 1293(b).

21 “(C) REGULATIONS OR OTHER GUID-
22 ANCE.—The Secretary shall issue such regula-
23 tions or other guidance as is necessary or ap-
24 propriate to carry out the purposes of this para-
25 graph, including regulations which apply the

1 rules of subparagraph (A) in similar cir-
2 cumstances or with respect to similarly situated
3 persons.”.

4 (n) PENALTIES RELATED TO ADMINISTRATIVE AD-
5 JUSTMENT REQUESTS AND PARTNERSHIP ADJUSTMENT
6 TRACKING REPORTS.—

7 (1) FAILURE TO PAY.—Section 6651 is amend-
8 ed by redesignating subsection (i) as subsection (j)
9 and by inserting after subsection (h) the following
10 new subsection:

11 “(i) APPLICATION TO IMPUTED UNDERPAYMENT.—
12 For purposes of this section, any failure to comply with
13 section 6226(b)(4)(A)(ii) shall be treated as a failure to
14 pay the amount described in subclause (II) thereof and
15 such amount shall be treated for purposes of this section
16 as an amount shown as tax on a return specified in sub-
17 section (a)(1).”.

18 (2) FAILURE TO FILE PARTNERSHIP ADJUST-
19 MENT TRACKING REPORT.—Section 6698(a) is
20 amended—

21 (A) in the matter preceding paragraph (1)
22 by inserting “, or a partnership adjustment
23 tracking report under section 6226(b)(4)(A),”
24 after “under section 6031”,

1 (B) in paragraph (1) by inserting “, or
2 such report,” after “such return”, and

3 (C) in paragraph (2)—

4 (i) by inserting “or a report” after “a
5 return”, and

6 (ii) by inserting “or 6226(b)(4)(A),
7 respectively” before the comma at the end.

8 (3) TAX RETURN PREPARER RELATED PEN-
9 ALTIES.—Section 6696(e)(1) is amended by insert-
10 ing “, any administrative adjustment request under
11 section 6227, and any partnership adjustment track-
12 ing report under section 6226(b)(4)(A)” before the
13 period at the end.

14 (4) FRIVOLOUS TAX SUBMISSIONS.—Section
15 6702 is amended by adding at the end the following
16 new subsection:

17 “(f) PARTNERSHIP ADJUSTMENTS.—An administra-
18 tive adjustment request under section 6227 and a partner-
19 ship adjustment tracking report under section
20 6226(b)(4)(A) shall be treated as a return for purposes
21 of this section.”.

22 (o) ADJUSTED SCHEDULE K-1 TREATED AS PAYEE
23 STATEMENT.—Section 6724(d)(2) is amended by striking
24 “or” at the end of subparagraph (HH), by striking the
25 period at the end of subparagraph (II) and inserting “,

1 or”, and by inserting after subparagraph (II) the following
2 new subparagraph:

3 “(JJ) section 6226(a)(2) (relating to state-
4 ments relating to alternative to payment of im-
5 puted underpayment by partnership) or under
6 any other provision of this title which provides
7 for the application of rules similar to such sec-
8 tion.”.

9 (p) OTHER CLERICAL CORRECTIONS.—

10 (1) Section 6225(c)(7) is amended by striking
11 “submitted pursuant to paragraph (1)” and insert-
12 ing “filed or submitted under this subsection”.

13 (2) Section 6227(b) is amended by striking “is
14 made” both places it appears and inserting “is
15 filed”.

16 (3) Section 6227(b)(1) is amended by striking
17 “paragraphs (2), (6), and (7)” and inserting “para-
18 graphs (2), (7), and (9)”.

19 (4) Section 6232(b) is amended by striking
20 “this chapter” and inserting “this subtitle (other
21 than subchapter B of this chapter)”.

22 (5) Section 6232(d)(1)(A) is amended by strik-
23 ing “a item” and inserting “an item”.

24 (6) Section 6232(e) is amended by striking
25 “thereof”.

1 (7) Section 6241(5) is amended by striking
2 “sections 6234” and inserting “section 6234”.

3 (8) Section 7485(b) is amended by striking “a
4 partner” and inserting “the partnership”.

5 (9) The heading of the first part of subchapter
6 C of chapter 63 is amended to read as follows:

7 **“PART I—IN GENERAL”.**

8 (10) The heading of the second part of sub-
9 chapter C of chapter 63 is amended to read as fol-
10 lows:

11 **“PART II—PARTNERSHIP ADJUSTMENTS”.**

12 (11) The heading of the third part of sub-
13 chapter C of chapter 63 is amended to read as fol-
14 lows:

15 **“PART III—PROCEDURE”.**

16 (12) The heading of the fourth part of sub-
17 chapter C of chapter 63 is amended to read as fol-
18 lows:

19 **“PART IV—DEFINITIONS AND SPECIAL RULES”.**

20 **SEC. 207. EFFECTIVE DATE.**

21 The amendments made by this title shall take effect
22 as if included in section 1101 of the Bipartisan Budget
23 Act of 2015.

APPENDIX B – Staff Report – 4-4-18

Joint Committee on Taxation - Excerpts

B. Title II — Technical Corrections Related to Partnership Audit Rules (sec. 1101 of the Bipartisan Budget Act of 2015 and secs. 6221-6241 of the Code)

The provisions correct and clarify provisions relating to the partnership audit rules enacted in the Bipartisan Budget Act of 2015, as amended by the PATH Act of 2015, to express the intended rule. Section and chapter references are to the Internal Revenue Code of 1986 unless otherwise indicated.

Scope of adjustments subject to partnership audit rules (sec. 201 of Division U of the amendment and secs. 6241(2) and (9), 6501(c), 6221, 6225, 6226, 6227, 6231, 6234, and 7485 of the Code)

The provision clarifies the scope of the partnership audit rules. The provision eliminates references to adjustments to partnership income, gain, loss, deduction, or credit, and instead refers to partnership-related items, defined as any item or amount with respect to the partnership that is relevant in determining the income tax liability of any person, without regard to whether the item or amount appears on the partnership's return and including an imputed underpayment and an item or amount relating to any transaction with, basis in, or liability of, the partnership. Thus, these partnership audit rules are not narrower than the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) partnership audit rules, but rather, are intended to have a scope sufficient to address those items described as partnership items, affected items, and computational items in the TEFRA context in Treasury Regulations sections 301.6231(a)(3), 301.6231(a)(5), and 301.6231(a)(6), as well as any other items meeting the statutory definition of a partnership-related item.

For example, because a partnership-related item includes an item or amount relating to any transaction with the partnership, an item or amount relating to a partner's transaction with a partnership other than in his capacity as a member of the partnership (which is considered as occurring between the partnership and one who is not a partner under section 707) is a partnership-related item. As another example, because a partnership-related item includes an item or amount relating to basis in the partnership, an item or amount relating to the determination of the adjusted basis of a partner's interest in the partnership or relating to the basis of the partnership in partnership property is a partnership-related item. As a further example, because a partnership-related item includes an item or amount relating to liability of the partnership, an item or amount relating to the determination of partnership liabilities or to the effect on a partner of a decrease or increase in a partner's share of partnership liabilities is a partnership-related item.

The provision clarifies that the partnership audit rules do not apply to taxes imposed, or to amounts required to be deducted or withheld, under Code chapters 2 (tax on self-employment income) or 2A (tax on net investment income), 3 (withholding tax on nonresident alien individuals or foreign corporations), or 4 (withholding tax for certain foreign accounts), except as otherwise specifically provided. However, any partnership adjustment determined under the income tax is taken into account for purposes of determining and assessing tax under these chapters of the Code to the extent that the partnership adjustment is relevant to the determination. Further, a timing rule applies in the case of chapters 3 and 4.

For example, if a partnership adjustment results in a change in the amount of income of an individual from a partnership, the change is reflected as required under the rules of chapter 2 in the calculation of the individual's

net earnings from self-employment with respect to the partnership, and the chapter 2 tax may be collected through a process that is outside the partnership audit rules.

The period for assessing any tax under chapter 2 or 2A that is attributable to a partnership adjustment does not expire before the date that is one year after (1) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under Code section 6234, such decision becomes final, or (2) in any other case, 90 days after the date on which the notice of final partnership adjustment is mailed under Code section 6231.

The provision applies a specific timing rule in the case of any tax imposed, including any amount that is required to be deducted or withheld, under chapter 3 (withholding tax on nonresident alien individuals or foreign corporations) or 4 (withholding tax for certain foreign accounts). In these cases, the tax is determined with respect to the reviewed year. The tax is imposed with respect to the adjustment year; similarly, the amount required to be deducted or withheld is deducted or withheld with respect to the adjustment year. The reviewed year and the adjustment year are defined in section 6225(d). For example, assume that a partnership has foreign partners, and that following an audit of the partnership, an adjustment is made to the amount of the partnership's effectively connected taxable income. The adjustment results in an increase of \$100x of such income that is allocable to foreign partners with respect to the reviewed year. Pursuant to section 1446, assume that the amount of withholding tax that the partnership is required to pay with respect to this income allocable to the foreign partners is \$35x. The \$35x is required to be paid by the partnership with respect to the adjustment year (as defined in section 6225(d)(2)). As a further example, assume that a partnership, P, with foreign partners is not the audited partnership, but rather, is an upper tier partner of an audited partnership that has elected to push out under section 6226. Partnership P has received a statement pursuant to section 6226, described below. The amount of withholding tax partnership P is required to pay is determined with respect to the reviewed year of the audited partnership, as it affects the relevant taxable year of partnership P. The amount of withholding tax is required to be paid by partnership P for the partnership taxable year that is the adjustment year, in this case, the adjustment year of the audited partnership (sec. 6225(d)). The due date for partnership P's payment of the withholding tax is no later than the due date (including allowable extensions) for the return for the adjustment year of the audited partnership.

In determining the amount of any deficiency, adjustments to partnership-related items are made only as provided under the partnership audit rules (Subchapter C of Chapter 63 of the Code), except to the extent otherwise provided. Conforming references to partnership-related items are made in several other provisions, including the provision relating to the scope of judicial review of a partnership adjustment (sec. 6234(c)).

Thus, it is clarified that the court has jurisdiction to determine all partnership-related items of the partnership for the partnership taxable year to which the notice of final partnership adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under subchapter C of chapter 63 of the Code. For example, because partnership-related items include items or amounts with respect to (a) section 707 transactions, (b) liabilities of the partnership and the partners' shares of the liabilities, and (c) the basis of a partnership interest or of partnership property, determination of these items or amounts is within the scope of judicial review.

Netting in the determination of imputed underpayments (sec. 202 of Division U of the amendment and sec. 6225 (a) and (b) of the Code)

When the Secretary makes adjustments to any partnership-related item with respect to the reviewed year of a partnership, if the adjustments result in an imputed underpayment, the partnership pays an amount equal to the imputed underpayment, and if the adjustments do not result in an imputed underpayment, the adjustments are taken into account by the partnership in the adjustment year and passed through to the adjustment year partners. The provision clarifies this rule by conforming the language referring to partnership-related items and by striking erroneous references to separately stated income or loss.

The provision clarifies the manner of netting items to determine the amount of an imputed underpayment of a partnership. The provision clarifies that items of different character (capital or ordinary), for example, are not netted together in determining the amount of an imputed underpayment. Rather, an imputed underpayment of a partnership with respect to a reviewed year is determined by the Secretary by appropriately netting partnership adjustments for that year and by applying the highest rate of tax in effect for the reviewed year under section 1 or 11.

In the case of partners' distributive shares, like items within categories under section 702(a)(1)-(8) are separately netted. For example, netting within categories of items that are netted for purposes of reporting to partners on Schedule K-1 pursuant to section 702 may be considered as appropriately netting.

In determining an imputed underpayment, any adjustment that reallocates the distributive share of any item from one partner to another is taken into account by disregarding any part of the adjustment that results in a decrease in the amount of the imputed underpayment. For example, this rule could be implemented by disregarding the decrease in any item of income or gain and disregarding the increase in any item of deduction, loss, or credit.

Limitations that would apply at the direct or indirect partner level are treated as applying, unless otherwise determined. Under the provision, if an adjustment would decrease the imputed underpayment, and could be subject to a limitation or not be allowed against ordinary income if the adjustment were taken into account by any person, then the adjustment is not taken into account in determining the imputed underpayment of the partnership, except to the extent the Secretary otherwise provides.

For example, if an adjustment would increase the amount of a partnership loss allocable to partners, but the loss could be subject to the passive loss rule of section 469 in the hands of direct and indirect partners of the partnership, then the Secretary does not take into account the adjustment increasing the loss in determining the amount of the partnership's imputed underpayment, unless the Secretary provides otherwise. For example, the Secretary may provide otherwise if the partnership supplies accurate information that all direct and indirect partners of the partnership are publicly traded domestic C corporations not subject to the passive loss rule.

Adjustments to credits are separately determined and netted as appropriate. Adjustments to credits are not multiplied by the tax rate, but rather, adjustments to items of credit are taken into account as an increase or decrease in determining the amount of the imputed underpayment.

It is intended that an imputed underpayment may be modified under procedures described in section 6225(c).

Alternative procedure to filing amended returns for purposes of modifications to imputed underpayments (secs. 202(b), 202(c)(2), 203, and 206(b) of Division U of the amendment and secs. 6225(c) and 6201(a)(1) of the Code)

The provision clarifies the modification rules of section 6225(c) to better carry out their function as intended by Congress, that is, to determine the amount of tax due as closely as possible to the tax due if the partnership and partners had correctly reported and paid while at the same time to implement the most efficient and prompt assessment and collection of tax attributable to the income of the partnership and partners.

The provision clarifies the procedures under section 6225(c)(2) that permit a partnership to seek modification of an imputed underpayment. These procedures allow reviewed-year partners to take adjustments into account so that the partnership's imputed underpayment can be determined by the Secretary without regard to that portion of the adjustments. Like other modification procedures in section 6225(c), these procedures take place within the period ending 270 days after the date the notice of proposed partnership adjustment is mailed, unless the period is extended with the consent of the Secretary, as provided in section 6225(c)(7).

Amended returns of partners

The provision clarifies the requirements for reviewed-year partners filing amended returns with payment of any tax due. First, the amended return procedure requires the partner to file returns for the taxable year of the partner that includes the end of the partnership's reviewed year, as well as for any taxable year with respect to which any tax attribute of the partner is affected by reason of any adjustment to a reviewed-year partnership-related item. Second, the amended returns are required to take into account all such adjustments that are properly allocable to the partner, as well as the effect of the adjustments on any tax attributes. Third, payment of any tax due is required to be included with the amended returns. As is the case for other amended returns, the Secretary may require the payment of interest, penalties, and additions to tax (for example, by billing the partner as under present practice).

If the requirements are satisfied, then the partnership's imputed underpayment amount is determined without regard to the portion of the adjustments taken into account by such partners. The amended return modification procedure does not require the participation of all reviewed year partners of the partnership. Direct and indirect reviewed-year partners may participate. The amended return procedure is not intended to cover adjustments to items on an amended return of a partner that do not correspond to adjustments to a reviewed-year partnership-related item and the effect of the adjustments on tax attributes.

Alternative procedure to filing amended returns (pull-in)

The provision sets forth an alternative procedure to filing amended returns. The alternative procedure is referred to as the pull-in procedure. Under the pull-in procedure, the Secretary determines the partnership's imputed underpayment as reduced by the portion of the adjustments to partnership-related items that direct and indirect reviewed-year partners take into account and with respect to which those partners pay the tax due, provided the requirements of the pull-in procedure are met.

Under pull-in, reviewed-year partners pay the tax that would be due with amended returns, make binding changes to their tax attributes for subsequent years, and provide the Secretary with the information necessary to substantiate that the tax was correctly computed and paid. However, the partners file no amended returns. Thus, there are generally no corollary effects on the partners' returns beyond the effects on tax attributes, in other taxable years, of the adjustments to partnership-related items.

Pull-in, as well as the amended return modification procedure, is available generally to direct and indirect reviewed-year partners, in the case of tiered partnerships. The pull-in procedure generally does not require the participation of all direct and indirect reviewed-year partners of the partnership.

Pull-in requires the participating partner to pay the tax that would be due under the amended return filing procedure. The partner is responsible for remitting the payment unless the Secretary provides that another person, such as the partnership or a third party, may remit the payment on the partner's behalf. Payment is due within the period ending 270 days after the date the notice of proposed partnership adjustment is mailed (unless the period is extended with the Secretary's consent).

Pull-in requires that the partner agree to take into account, in the form and manner required by the Secretary, the adjustments and the effects on the partner's tax attributes of the adjustments to partnership-related items properly allocable to the partner.

Pull-in requires that the partner provide, in the form and manner specified by the Secretary, such information as the Secretary may require to carry out the pull-in procedure. This requirement can include information in the same form as on an amended return, if the Secretary so specifies. The information is to be provided within the

period ending 270 days after the date the notice of proposed partnership adjustment is mailed (unless the period is extended with the Secretary's consent).

If all of the requirements are satisfied, the imputed underpayment can be modified. In the event that a partner provides the required information, but does not make the required payment, for example, the imputed underpayment of the partnership is not modified with respect to those adjustments.

For the administrative convenience of taxpayers and the Secretary, it is intended that partner payments and partner information may be collected centrally and remitted to the Secretary under the pull-in procedure. This centralization could be administered by the Secretary, by the partnership representative, or by a third party. For example, the procedure may permit a third party such as an accounting or law firm designated by the partnership representative to collect partner information required under the procedure and tally partner payments before remitting this information to the Secretary. Such a practice may be useful both to facilitate centralized tracking and collection of the information and payments, and to address privacy concerns partners may have in sharing information with the partnership representative. Particularly in the case of partnerships with numerous partners or direct and indirect partners, such a practice may alleviate the administrative burdens on the Secretary and taxpayers, consistently with the Congressional intent for the centralized partnership audit system to improve the efficiency, promptness, and accuracy of collection of partners' taxes due with respect to partnership-related items.

Assessment authority with respect to payments under the pull-in procedure is provided under section 6201.

Rules applicable both to the amended returns of partners and to the pull-in procedure

If an adjustment involves reallocation of an item from one partner to another, the opportunity to modify the imputed underpayment under amended return procedure (sec. 6225(c)(2)(A)) or pull-in procedures (sec. 6225(c)(2)(B)) is available only if the requirements of one or the other of the amended return or pull-in procedures are satisfied with respect to all partners affected by the adjustment involving reallocation.

For purposes of the amended return and pull-in procedures, tax relating to adjustments to a reviewed-year partnership-related item and the effect of the adjustments on tax attributes may be determined and assessed without regard to the otherwise applicable statute of limitations of sections 6501 and 6511. For example, if a notice of proposed partnership adjustment is mailed to a partnership by the Secretary more than three years after a partner filed his or her return for the year including the end of the reviewed year, the three-year statute of limitations under section 6501 or 6511 does not preclude the filing of an amended return, the assessment and payment of the partner's tax due for that year, or the proper crediting or refund of an amount paid by a partner, but these results apply only with respect to adjustments to partnership-related items for the reviewed year (and the effect of such adjustments on any tax attributes).

In the case of adjustments taken into account on an amended return of a partner or in a pull-in with respect to a partner, the effects of these adjustments on tax attributes are binding. This binding effect applies for the taxable year of the partner that includes the end of the reviewed year of the partnership and any taxable year for which a tax attribute is affected by such an adjustment. Any failure to take into account the effects of adjustments on tax attributes is treated for all Federal tax purposes in the same manner as a failure by a partner to treat a partnership-related item consistently with the treatment of the item on the partnership return (as provided in section 6222). For example, if a partner who files an amended return or provides information in a pull-in fails to take into account in other taxable years the effect on tax attributes of adjustments to partnership-related items that are properly allocable to the partner, any underpayment attributable to the failure may be assessed under math error procedures as provided in section 6222(b).

The provision clarifies the rules applicable in the case of partnerships and S corporations in tiered structures when a partner files an amended return and pays, or provides information to the Secretary and pays in a pull-in. Specifically, in the case of any partnership, any partner of which is a partnership, the amended return and pull-in rules of section 6225(c)(2)((A) and (B) apply with respect to any partner (the “relevant partner”) in the chain of ownership of such partnerships, provided that certain requirements are met. As a practical matter, this rule generally permits the filing of amended returns even if some, but not all, of the partners (or S corporation shareholders treated as partners for this purpose) file amended returns. Similarly, this rule generally permits some but not all partners to participate in a pull-in, provided requirements are met.

Requirements applicable to both the amended return procedure and the pull-in procedure include the requirement that such information as the Secretary may require be furnished to the Secretary for purposes of administering the amended return or pull-in rules in the case of tiered structures. In this context, the Secretary may require information with respect to any chain of ownership of the relevant partner. The Secretary may require that each partnership in the chain of ownership between the relevant partner and the audited partnership must satisfy the requirements for filing amended returns or for participating in the pull-in, so that all partnerships in the chain of ownership between the relevant partner and the audited partnership either meets the requirement of filing an amended return, or meets the requirements for supplying information in a pull-in.

For example, an audited partnership has three partners, A, B, and C, each of which is a partnership. Partnership B in turn has two partners, D and E, each of which is a partnership. Partnerships A, C, D, and E each have only 5 partners. Individual Q is a partner in partnership E, and agrees to participate in a pull-in, pay the tax due, and provide information as required by the Secretary (including information similar to that which would be supplied on an amended return of Q, and information with respect to the chain of ownership between Q as the relevant partner and the audited partnership). The provision does not contemplate that the Secretary may require Q to supply information about the chain of ownership between the audited partnership and upper-tier partners of partnerships A, C, or D. However, partners of A, C, or D that file amended returns or participate in the pull-in may be required to supply information on the chain of ownership between themselves and the audited partnership, as well as information on their own chains of ownership should they be partnerships or S corporations.

Other modification procedures: references to adjustments

The provision clarifies the operation of modification procedures under sections 6225(c)(3) (relating to tax-exempt partners), 6225(c)(4) (relating to applicable highest tax rates), and 6225(c)(5) (relating to certain passive losses of publicly traded partnerships). In each of these modification procedures, the provision clarifies that the determination of the imputed underpayment is made without regard to the adjustment or portion of the adjustment being described (not without regard to a portion of the imputed underpayment).

Other modification procedures: adjustment not resulting in an imputed underpayment

The provision states specifically that the modification procedures are available if adjustments to partnership-related items do not result in an imputed underpayment. Under section 6225(c)(9), information relating to a modification may be offered by the partnership in the case of adjustments that do not result in an imputed underpayment, and such adjustments may be modified by the Secretary as the Secretary determines appropriate.

Push-out treatment of passthrough partners in tiered structures (sec. 204 of Division U of the amendment and sec. 6226 of the Code)

The provision addresses the situation of a partnership (or an S corporation, which is treated similarly to a partnership under this rule) that is a direct or indirect partner of an audited partnership which has elected to

push out adjustments of partnership-related items to partners (or S corporation shareholders, which are treated similarly to partners under this rule) under section 6226. The provision sets forth requirements applicable to such partners and the time frame for satisfying these requirements.

If a partner that receives a statement in a push-out is a partnership, that partner must satisfy two requirements. First, the partner must file with the Secretary a partnership adjustment tracking report that includes information required by the Secretary. For example, the required information may include identifying the partner's own partners or shareholders, describing and quantifying adjustments necessary to determine partnership-related items or the equivalent in the hands of those partners or shareholders, or other information necessary or appropriate to assessment and collection from tiers of partners in a push-out.

Second, that partner is required to furnish statements to its partners under rules similar to section 6226(a)(2), or, if no such statements are furnished, to compute and pay its imputed underpayment under rules similar to section 6225 (other than certain modification-related rules). That is, the partnership must push out the adjustments to its partners, or if not, it must compute and pay its imputed underpayment. If such a partnership computes and pays its imputed underpayment, the rules of section 6225 apply (other than the modifications provided in section 6225(c)(2) (amended returns and pull-in), 6225(c)(7) (270-day period for modifications), and 6225(c)(9) (modification of adjustment not resulting in imputed underpayment)). The imputed underpayment of the partnership is determined by appropriately netting all partnership adjustments on the statement (taking into account limitations to which adjustments that decrease the imputed underpayment could be subject) and applying the highest rate of tax in effect for the reviewed year under section 1 or 11, as provided in section 6225. The partnership pays its imputed underpayment as so determined.

The due date for the payment of the imputed underpayment or furnishing of partner statements and the filing of the partnership adjustment tracking report is the return due date (including allowable extensions) for the adjustment year of the audited partnership. That is, the partnership adjustment tracking report must be filed with the Secretary, and the imputed underpayment paid or statements furnished to partners or S corporation shareholders (or if not so furnished, an imputed underpayment must be paid), not later than the due date for the adjustment year of the audited partnership. In the case of a partner that is not a partnership or an S corporation and that receives a statement in a push-out, the partner's tax is increased for the partner's taxable year that includes the date of the statement, as provided in section 6226(b). In the case of partner that is a trust and that receives a statement in a push-out, regulatory authority to provide any necessary rules is set forth.

The provision defines an audited partnership for purposes of the push-out treatment of passthrough partners in tiered structures under section 6226(b)(4). With respect to a partner that is a partnership or an S corporation and that receives a statement in a push-out, the audited partnership is the partnership in the chain of ownership originally electing the application of section 6226.

Treatment of failure of partnership or S corporation to pay imputed underpayment and assessment and collection authority with respect to imputed underpayments (sec. 205 of Division U of the amendment and secs. 6232 and 6501(c)(4)(a) of the Code)

Under the provision, if, following an assessment, a partnership fails to pay an imputed underpayment within 10 days after the date of notice and demand by the Secretary, the applicable interest rate increases, and assessment and collection against adjustment-year partners for their proportionate shares may be made. The interest rate under the provision is the underpayment rate as modified, that is, the rate is the sum of the Federal short-term rate (determined monthly) plus 5 percentage points. An S corporation and its shareholders are treated like a partnership and its partners under the provision.

The provision applies if, within 10 days of notice and demand for payment, a partnership fails to pay an imputed underpayment under section 6225 or any interest or penalties under section 6233. For example, the

increased interest rate applies and assessment and collection from adjustment year partners may be made in the case of a partnership that has not elected under section 6226 to push out adjustments to partners nevertheless fails to pay within 10 days of notice and demand.

The provision also applies if any specified similar amount (or interest or penalties with respect to the amount) have not been paid. A specified similar amount arises if a partner that is an upper-tier partnership or S corporation in a push-out fails to pay an imputed underpayment under section 6226(b)(4)(A)(ii) (including any failure to furnish statements that is treated as a failure to pay an imputed underpayment under section 6651(i)). A specified similar amount also includes an amount required to be paid by former partners (including partners that are themselves partnerships) of a partnership that has ceased to exist or terminated (not including a technical termination) as well as interest or penalties with respect to the amount.

The date of the notice and demand for payment initiates a two-year period in which the Secretary may assess against the adjustment-year partners (or former partners). The two-year period of limitations also applies to a proceeding begun in court without assessment with respect to a partner. The period may be extended by agreement.

The provision expands the present-law section 6501(c)(4) rule permitting extension by agreement between the Secretary and the taxpayer of the time period for assessment. As a result, that rule permitting extension by agreement is not limited to assessment periods prescribed in section 6501, but rather, applies more broadly to assessment periods and in particular applies to the period for assessment against partners in the case of failure of a partnership to pay an imputed underpayment after notice and demand under section 6232(f).

If a partnership has ceased to exist or terminated (not including a technical termination) within the meaning of Code section 6241(7), the provision applies with respect to the former partners of the partnership. For example, the former partners of the partnership may be the partners for the most recent period before the partnership ceased to exist or terminated, such as the partners for purposes of the last return filed by the partnership.

A partner is liable for no more than the partner's proportionate share of the imputed underpayment, interest, and penalties, measured as the Secretary determines on the basis of the partner's distributive share of items. For example, the distributive shares set forth in the partnership agreement, or as determined for purposes of Schedule K-1, may serve as a measure of a partner's proportionate share. The Secretary is required to determine partners' proportionate shares so that the aggregate proportionate shares so determined total 100 percent. Thus, no partner is required to pay more than the partner's proportionate share of the imputed underpayment, interest, and penalties.

Partner payments under this provision reduce the partnership's liability to pay. The partnership's liability is not reduced by partner payments if such payments are made after the date on which the partnership pays, however. For example, if a partnership's liability is \$100, and partner payments aggregating \$60 before July 15 reduce the partnership's liability to \$40, and the partnership pays \$40 on July 15, a partner payment of \$40 on August 1 does not reduce the partnership's liability. The partnership may not receive a credit or refund for any part of the partner payment of \$40; the partner, however, may.

The Secretary may assess the tax, interest, and penalties on the proportionate share of each partner (as of the close of the adjustment year) of the partnership without regard to the deficiency procedures generally applicable to income tax. Under the provision, assessment may not be made (or proceeding in court begun without assessment) after the date that is two years after the date on which the Secretary provides notice and demand.

Amendment of statements (Schedule K-1s) to partners (sec. 206(a) of Division U of the amendment and sec. 6031(b) of the Code)

The provision clarifies that a partnership that has validly elected out of the partnership audit rules under section 6221(b), and therefore is not subject to the partnership audit rules, may amend partner statements (Schedule K-1s) after the due date of the partnership return to which the statements relate.

Partnership adjustment tracking report and administrative adjustment request not treated as amended return (sec. 206(b) of Division U of the amendment and sec. 6225(c)(2) of the Code)

The provision clarifies that neither the partnership adjustment tracking report required to be filed in a push-out, nor an administrative adjustment request submitted under section 6227, is treated as a return for purposes of modifying an imputed underpayment of a partnership through partner amended return filings and payments under section 6225(c)(2)(A). Only a return of a partner satisfies the requirement under the partner amended return filing modification procedure.

Authority to require e-filing of materials (sec. 206(c) of Division U of the amendment and sec. 6241(10) of the Code)

Authority is provided for the Secretary to require electronic filing or submission of anything that has to be filed or submitted in connection with procedures for modifying the imputed underpayment amount under section 6225(c). Authority is also provided for the Secretary to require electronic filing or furnishing of anything that has to be furnished to or filed with the Secretary in connection with the push-out procedures under section 6226.

Clarification of assessment authority in a push-out (sec. 206(d) of Division U of the amendment and sec. 6226 of the Code)

The provision clarifies that, in the case of a partnership that has validly elected under section 6226 (push-out) in the manner that the Secretary provides, no assessment of tax, levy, or proceeding in court for the collection of the imputed underpayment is to be made against the audited partnership.

Treatment of partnership adjustments that result in decrease in tax in push-out (sec. 206(e) of Division U of the amendment and sec. 6226(b) of the Code)

As an alternative to partnership payment of the imputed underpayment in the adjustment year, the audited partnership may elect to furnish to the Secretary and to each partner of the partnership for the reviewed year a statement of the partner's share of any adjustments to partnership-related items as determined by reference to the final determination with respect to the adjustment. In this situation section 6225, requiring the audited partnership to pay the imputed underpayment, does not apply. Instead, each reviewed-year partner takes the adjustments into account for the taxable year that includes the date of the statement and pays the tax as provided in section 6226 (taking into account section 6226(b)(4)).

The provision provides that in taking into account adjustments to determine a partner's tax in a push-out, decreases as well as increases in the partner's tax are taken into account. The provision clarifies that in a push-out, the partner's tax for the taxable year that includes the date of the statement is adjusted by the aggregate of the correction amounts (not adjustment amounts).

The correction amount for a particular taxable year of a partner takes into account both decreases and increases. That is, the correction amount for the partner's taxable year that includes the end of the reviewed year is the amount by which the income tax would increase or decrease if the partner's share of adjustments were taken into account for that year. Similarly, the correction amount for any taxable year of the partner after that year, and before the year that includes the date of the statement, is the amount by which the income tax would increase or decrease if the partner's share of adjustments were taken into account for that year. The

present-law treatment of mathematical or clerical errors applies with respect to correction amounts and aggregate correction amounts.

Coordination with adjustments related to foreign tax credits (sec. 206(f) of Division U of the amendment and sec. 6227(d) of the Code)

The provision clarifies that the Secretary is to issue regulations or other guidance providing for the proper coordination of section 6227, relating to administrative adjustment requests by the partnership, with the rule of section 905(c), relating to foreign tax credits and redetermination of the amount of tax in certain circumstances.

Clarification of assessment of imputed underpayments (sec. 206(g) of Division U of the amendment and secs. 6232(a) and (b) of the Code)

The provision clarifies that the assessment of any imputed underpayment is not subject to the deficiency procedures of subchapter B of chapter 63. Rather, they are assessed and collected in accordance with the rules of subchapter C of chapter 63. Any imputed underpayment (including an imputed underpayment under section 6226(b)(4)(A)(ii) of a partnership or S corporation that is a direct or indirect partner of an audited partnership in a push-out) is assessable under the provision.

The provision clarifies that in the case of an administrative adjustment request to which section 6227(b)(1) applies, the underpayment must be paid, and may be assessed, when the request is filed. A reference in section 6232(b) to the assessment of a deficiency is corrected to refer to the assessment of an imputed underpayment. Generally, then, an imputed underpayment of a partnership may not be assessed or collected before the close of the 90th day after the day on which a notice of final partnership adjustment was mailed, and if a petition is filed under section 6234 with respect to the notice, the decision of the court has become final.

However, the restrictions on assessment and collection of an imputed underpayment provided generally under section 6232(b) do not apply in the case of any specified similar amount within the meaning of section 6232(f)(2). As a result, the restrictions do not apply to the imputed underpayment of partner that is a partnership or S corporation in a push-out. A specified similar amount means the amount described in section 6226(b)(4)(A)(ii)(II), including an failure to furnish statements to partners or S corporation shareholders that is treated as a failure to pay that amount under section 6651(i). A specified similar amount also means any amount assessed on a partner that is a partnership or S corporation. Thus, for example, these restrictions do not apply to assessment and collection of an imputed underpayment of a partnership or S corporation that receives a statement in a push-out and neither timely furnishes statements to its partners or shareholders nor pays its imputed underpayment.

Time limit for notice of proposed partnership adjustment (sec. 206(h) of Division U of the amendment and secs. 6231(a) and (b) of the Code)

The provision clarifies that a notice of proposed partnership adjustment must be mailed within the applicable period of limitations on making adjustments under the partnership audit rules (subchapter C of chapter 63 of the Code). The notice of proposed partnership adjustment cannot be relied upon to revive an otherwise expired limitations period under section 6235. For purposes of determining whether or not a notice of proposed partnership adjustment is timely, the applicable limitations period is determined under section 6235, determined without regard to section 6235(a)(2) (relating to the period for modification of an imputed underpayment under section 6225(c)(7)), and without regard to section 6235(a)(3) (relating to the 330-day period (or the period as extended) for making an adjustment after the date of a notice of proposed partnership adjustment).

The provision does not alter the section 6231(b)(2) prohibition against mailing any notice of final partnership adjustment earlier than 270 days after the date on which the notice of proposed partnership adjustment is mailed (except to the extent the partnership elects to waive the prohibition).

Deposit to suspend interest on imputed underpayment (sec. 206(i) of Division U of the amendment and sec. 6233 of the Code)

The provision clarifies that, before the due date for payment of an imputed underpayment, a partnership (or, in the case of a partner payment pursuant to an election under section 6226, a partner) may make a cash deposit to suspend the running of interest as provided under present-law rules in section 6603. The deposit is not treated as a tax payment.

Deposit to meet jurisdictional requirement (sec. 206(j) of Division U of the amendment and sec. 6234(b) of the Code)

The provision clarifies that the amount of the jurisdictional deposit that the partnership must make in order to file a readjustment petition in court is the amount of (as of the date of the filing of the petition) the imputed underpayment, penalties, additions to tax, and additional amounts with respect to the imputed underpayment (not just the imputed underpayment amount).

Period of limitations on making adjustments (sec. 206(k) of Division U of the amendment and sec. 6235 of the Code)

The provision clarifies several rules relating to the period of limitations on making adjustments. The provision makes clear that the period of limitations on making adjustments under subchapter C of chapter 63 does not limit the period for notification of the Secretary and redetermination of tax under section 905(c). The provision corrects a cross reference so that it refers to subchapter C of chapter 63 (rather than to a nonexistent subpart). The provision clarifies a reference to the penalty for substantial omission of income to incorporate a reference to constructive dividends, not just to other omitted items. The provision clarifies that the time for making any adjustment under subchapter C of chapter 63 with respect to any tax return, event, or period does not expire before the date determined under section 6501(c)(8) (relating to the failure to notify the Secretary of certain foreign transfers), that is, generally, the date that is three years after the date on which the Secretary is furnished the information required to be reported. The provision clarifies that the time for making any adjustment under subchapter C of chapter 63 with respect to a listed transaction described in section 6501(c)(10) does not expire the date determined under section 6501(c)(10), that is, generally, the date that is one year after the earlier of the date on which the Secretary is furnished the information required to be reported or the date on which a material advisor meets certain applicable requirements. The provision is clarified by striking section 6235(d), a provision included in prior law that has no effect under subchapter C of chapter 63.

Treatment of special enforcement matters (sec. 206(l) of Division U of the amendment and sec. 6241(10) of the Code)

The provision provides regulatory authority similar to that under the prior-law TEFRA partnership audit rules. It provides that in the case of partnership-related items involving special enforcement matters, the Secretary may prescribe guidance under which the partnership audit rules (or any portion of the rules) do not apply, and the special enforcement items are subject to special rules, including rules related to assessment and collection that are needed for effective and efficient enforcement. Special enforcement matters mean: failure to comply with the requirements of section 6226(b)(4)(A)(ii) to pay the imputed underpayment if the requirement to furnish statements has not been satisfied, termination and jeopardy assessments, criminal investigations, indirect methods of proof of income, foreign partners or partnerships, and other matters presenting special enforcement considerations.

United States shareholders and certain other persons treated as partners (sec. 206(m) of Division U of the amendment and sec. 6241(12) of the Code)

The provision clarifies the treatment under the rules of subchapter C of chapter 63 of United States shareholders and certain other persons treated as partners. Except as otherwise provided in guidance promulgated by the Secretary, in the case of a controlled foreign corporation (defined in section 957 or 953(c)(1)) that is a partner of a partnership, each United States shareholder is treated under subchapter C of chapter 63 as a partner in the partnership. For this purpose, except as otherwise provided by the Secretary, the distributive share with respect to the partnership equals the United States shareholder's pro rata share with respect to the controlled foreign corporation, determined under rules similar to the rules for determining its pro rata share of subpart F income under section 951(a)(2).

The provision also makes clear the treatment under subchapter C of chapter 63 of a passive foreign investment company ("PFIC") that is a partner in a partnership and that is a qualified electing fund with respect to a taxpayer pursuant to the taxpayer's election under section 1295. In the case of such a taxpayer, for purposes of the foregoing rule treating the taxpayer as a partner in the partnership, the taxpayer's distributive share with respect to the partnership equals the taxpayer's pro rata share with respect to the PFIC, determined under rules similar to the rules for determining the taxpayer's pro rata share under section 1293(b) (relating to pro rata share for purposes of current taxation of income from qualified electing funds).

Under the provision, authority for Treasury regulations or other guidance is provided as is necessary or appropriate to carry out the legislative purpose or to apply the rule treating persons as partners in similar circumstances or with respect to similarly situated persons.

Penalties relating to administrative adjustment requests and partnership adjustment tracking reports (sec. 206(n) of Division U of the amendment and secs. 6651, 6696, 6698, and 6702 of the Code)

The provision clarifies existing penalty provisions to ensure that they address compliance with the partnership audit rules. A partnership adjustment tracking report required to be filed pursuant to a section 6226 election is treated as a return for purposes of penalties relating to failure to file a partnership return, frivolous position submissions, and preparation of tax returns for other persons. A failure to comply with section 6226(b)(4)(A)(ii)(II), relating to the requirement to furnish statements in a push-out, is treated as a failure to pay an imputed underpayment for purposes of the penalty relating to failure to file a tax return or to pay tax. An administrative adjustment request under section 6227 is treated as a return for purposes of penalties relating to frivolous position submissions and the preparation of tax returns for other persons. Section 206(b) of Division U of the amendment, however, clarifies that neither an administrative adjustment request under section 6227 nor a partnership adjustment tracking report under section 6226(b)(4)(A) is treated as a return for purposes of the partner amended return modification procedure of section 6225(c)(2)(A).

Statements to partners (adjusted schedules K-1) treated as payee statements (sec. 206(o) of Division U of the amendment and sec. 6724 of the Code)

The provision clarifies that for purposes of the penalty for failure to furnish correct payee statements and the penalty for failure to file correct information returns, statements required to be furnished to partners in a push-out under section 6226(a)(2), or statements required to be furnished to partners under rules similar to section 6226(a)(2), are treated as payee statements. Statements required to be furnished to partners under rules similar to section 6226(a)(2) include statements furnished to partners pursuant to an administrative adjustment request under section 6227.

Clerical corrections relating to partnership audit rules (sec. 206(p) of Division U of the amendment)

The provisions make clerical corrections to the partnership audit rules.

APPENDIX C – Staff Report – April 4, 2018

Version Submitted by Interested Parties, January 3, 2018,
Modified with MTC Suggested Revisions and Edits, January 23, 2018,
Updated by Interested Parties, March 7, 2018
LATEST CHANGES ACCEPTED – SUBSTANTIVE IP COMMENTS RETAINED,
New MTC Staff Edits (Shown) with Added Comments
and Conforming Changes (not shown) as of April 4, 2018

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

SECTION A. Definitions

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

- (1) “**Administrative Adjustment Request**” means an administrative adjustment request filed by a Partnership under IRC section 6227.
- (2) “**Audited Partnership**” means a Partnership subject to a ~~Federal Adjustment resulting from a Partnership Level Audit~~ resulting in a Federal Adjustment.
- (3) “**Corporate Partner**” means a Partner that is subject to tax under [reference to state law].
- (4) “**Direct Partner**” means a Partner that holds an interest directly in a Partnership or Pass-Through Entity.
- (5) “**Exempt Partner**” means a Partner that is exempt from taxation under [reference to State law] [except on Unrelated Business Taxable Income¹].
- (6) “**Federal Adjustment**” means a change to an item or amount determined under the Internal Revenue Code that is used by a Taxpayer to compute [State tax] owed 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 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].
- (7) “**Federal Adjustments Report**” includes ~~a methods or forms~~ required by [State Tax Agency] for use by a Taxpayer to report Final Federal Adjustments, including an amended [State] tax return, information return, or a uniform multistate report.
- (8) “**Federal Partnership Representative**” means 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).
- (9) “**Final Determination Date**” means the following:

Commented [HH1]: Under the unedited version – this definition could potentially apply to the partnership partners of the audited partnership.

Commented [HH2]: Clarification.

Commented [HH3]: My sense in reading this and other provisions referencing the FAR is that we are expecting states agencies, by instruction or regulation, to develop the parameters for the FAR which do not currently exist and are not set out in this model. This may be the focus of regulatory drafting (to come) but we may want to note that.

¹ Drafting note: This portion of definition should only be used by the [State] if it taxes unrelated business income.

(a) Except as provided in Paragraph (b) of this Subsection A(9), if the Federal Adjustment arises from an IRS audit or other action by the IRS, the Final Determination Date is the first day on which no Federal Adjustments arising from that audit or other action remain to be finally determined, whether by IRS decision and with respect to which all rights of appeal have been waived or exhausted, 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.

Commented [JH4]: Clarification.

(b) For Federal Adjustments arising from an IRS audit or other action by the IRS, 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 arising from that audit remain to be finally determined, as described in Paragraph (a) of this Subsection A(9), for the entire group.

Commented [JH5]: As written, a state could interpret the FDD for an audit to be the date that the FPA is issued, not when then right to challenge in Tax Court expires.

Commented [JH6]: Mirror (a)

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

Commented [JH7]: Tracks the preceding language in the definition – and is necessary given the omnibus bill changes to how modification returns will work.

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

(11) “**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.

(12) “**IRC**” means 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 applicable regulations as promulgated by the U.S. Department of the Treasury.²

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

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

Commented [JH8]: As defined – nonresident partner would mean both direct and indirect partners. This has an effect on how the partnership pays election works (see below).

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

Commented [JH9]: Needed for new calculations under partnership pays.

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

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

(18) “**Pass-Through Entity**” means an entity, other than a Partnership, that is not subject to tax under

² 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.”

[reference to State Law imposing tax on C corporations or other taxable entities].

- (19) **“Reallocation Adjustment”** means a Final Federal Adjustment resulting from a Partnership Level Audit or an Administrative Adjustment Request that changes the shares of items of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive Reallocation Adjustment means the portion of a Reallocation Adjustment that would increase federal income for one or more Direct Partners, and a negative Reallocation Adjustment means the portion of a Reallocation Adjustment that would decrease federal income for one or more Direct Partners [pursuant to Regulations under IRC section 6225].
- (20) **“Resident Partner”** means an individual, trust, or estate Partner that has his or her domicile in or is a resident for tax purposes in [State] for the relevant tax period.
- (21) **“Reviewed Year”** means the taxable year of a Partnership that is subject to a Partnership Level Audit from which Federal Adjustments arise.
- (22) **“Taxpayer”** means [insert reference to State definition] and, unless the context clearly indicates otherwise, includes a Partnership subject to a Partnership Level Audit or a Partnership that has made an Administrative Adjustment Request, as well as a Tiered Partner of that Partnership.
- (23) **“Tiered Partner”** means any Partner that is a Partnership or Pass-Through Entity.
- (24) **“Unrelated Business Taxable Income”** has the same meaning as defined in IRC section 512.³

Commented [FN10]: Because the Reallocation Adjustment is a federal concept, we believe the reference should be “federal income” as opposed to “state income” and included a reference to IRC regulations. Also, partnership would not know the specific state tax impact for each partner.

Commented [HH11]: Clarity.

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

Except in the case of Final Federal Adjustments that are required to be reported by a Partnership and its Partners and Indirect Partners using the procedures in Section C, a Taxpayer shall report and pay any [State] tax due with respect to Final Federal Adjustments arising from an audit or other action 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(c), or federal claim for refund as follows:

Commented [JH12]: Edited for consistent usage throughout

Reporting of Final Federal Adjustments. Except as provided in Subsection B(2), a Taxpayer shall file by filing a Federal Adjustments Report with the [State Tax Agency] for the Reviewed Year and, if applicable, paying the additional [State] tax owed by the Taxpayer no later than 180 days after the Final Determination Date.

Commented [HH13]: Assuming we accept the approach noted in the following comment, which takes the de minimis provision and makes it the subject of a regulation (and it appears there are no adverse comments), this change would also need to be made here.

- (1) _____

Commented [FN14]: Simplified and moved to new Section D.

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

Final Federal Adjustments arising from a Partnership Level Audit not reported on an amended federal return or other similar report under IRC section 6225(c) and adjustments arising from an Administrative Adjustment Request filed by a Partnership under IRC section 6227 shall be reported as required under this section C.

Commented [HH15]: Consistent with A(9)(c) and the omnibus changes to the modification process.

³ Drafting note: This term should only be used by the [State] if it taxes unrelated business income.

(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 that action, the State Partnership Representative for the Reviewed Year shall have the sole authority to act on behalf of the Partnership, and its ~~Direct~~ 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 in writing another person as its State Partnership Representative.
- (c) The [State Tax Agency] may establish reasonable qualifications for and procedures for designating a person, other than the Federal Partnership Representative, to be the State Partnership Representative.

Commented [JH16]: Wordsmithing – if we use Indirect, we should use Direct as well.

(2) **Reporting and Payment Requirements for Partnerships Subject to a Final Federal Adjustment and their Direct Partners.** Except for Final Federal Adjustments subject to a properly made election under Subsection C(3), Final Federal Adjustments resulting from a Partnership Level Audit or an Administrative Adjustment Request filed by a Partnership under IRC section 6227 shall be reported as follows:

- (a) The Partnership shall, no later than 90 days after the Final Determination Date,
 - (i) File a completed Federal Adjustments Report, including partner level information as required under [reference to State law], with [State Tax Agency]; and
 - (ii) Notify each of its Direct Partners of their distributive share of the adjustments in a manner as provided by the [State Tax Agency]; and
 - (iii) File an amended composite return for Direct Partners as required under [reference to State Law] and/or an amended withholding return for Direct Partners as required under [reference to State Law] and pay the additional amount due under [reference to State Law(s)] that would have been due had the Federal Adjustments been reported properly as required.
- (b) [Except as provided under {State law} for minimal tax liabilities]⁴, no later than 180 days after the Final Determination Date, each Direct Partner that is taxed under [reference to State law imposing tax on individuals, trusts, estates, C corporations, etc.] shall:
 - (i) File a Federal Adjustments Report reporting their distributive share of the adjustments reported to them under Subparagraph (a)(ii) of this Subsection C(2) as required under [reference to State Laws]; and
 - (ii) Pay any additional amount of tax due as if ~~the~~ Final Federal Adjustments had been

Commented [HH17]: I'm not sure what state law we are referencing here. As in a couple other areas, we may be expecting states to develop something that is not going to be included in this model. If that is the case, we should note it.

Commented [HH18]: This seems necessary.

Commented [HH19]: See also the comment related to the definition of the FAR above – this seems to reference laws further defining or incorporating the FAR into existing statutes that will also need to be developed. May at least need a drafter's note.

⁴ 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.

properly reported, plus any penalty and interest due under [reference to State law] and less any credit for related amounts paid or withheld and remitted on behalf of the Direct Partner under Subparagraph (a)(iii) of this Subsection (2).

(3) **Election – Partnership Pays.** Subject to the limitations in Paragraph (c) of this Subsection (3), an Audited Partnership making an election under this Subsection (3) shall:

- (a) No later than 90 days after the Final Determination Date, file a completed Federal Adjustments Report, including partner information, certify that it has used all available information to which it or its agents or representatives have access to in order to determine or reasonably estimate the residency of Direct Partners and residency and distributive shares of Indirect Partners, and notify the [State Agency] that it is making the election under this Subsection (3);
- (b) No later than 180 days after the Final Determination Date, pay an amount, determined as follows, in lieu of taxes owed by its Direct Partners and Indirect Partners:
 - (i) Exclude from Final Federal Adjustments and any positive Reallocation Adjustments the distributive share of these adjustments made to an Direct or Indirect Exempt Partner that is not Unrelated Business Taxable Income;
 - (ii) Exclude from Final Federal Adjustments and any positive Reallocation Adjustments the distributive share of these adjustments made to a Direct or Indirect Partner that has filed a Federal Adjustments Report and paid the [State] tax due, as required under Section B, for the distributive share of adjustments reported on a federal amended return or other report as required under IRC section 6225(c) to obtain a modification of federal tax owed;
 - (iii) For the total distributive shares of the remaining Final Federal Adjustments plus positive Reallocation Adjustments allocated to Direct Corporate Partners or Direct Exempt Partners subject to tax under [reference to State law] apportion and allocate such adjustments as provided under [reference to existing multi-state business activity allocation/apportion law or regulation], and multiply that amount by the highest tax rate under [reference to State law];
 - (iv) For the total distributive shares of the remaining Final Federal Adjustments plus positive Reallocation Adjustments allocated to Non-Resident Direct Partners subject to tax under [reference to State law applying to individuals and /or trusts] plus the total distributive shares allocated to Tiered Partners, less any distributive shares allocated to Indirect Resident Partners in Subparagraph (v) of this Paragraph B, determine the amount of such adjustments which is [State] source income under [reference to existing non-resident partner sourcing law or regulation], and multiply this [State] source income amount by the highest tax rate under [reference to State law applying to individuals and/or trusts];
 - (v) For the total distributive shares of the remaining Final Federal Adjustments plus positive Reallocation Adjustments allocated to Resident Direct and Indirect Partners subject to tax under [reference to State Law applying to individuals and /or trusts], multiply that amount by the highest tax rate under [reference to State Law applying to individuals and/or trusts];
- (vi) Add the amounts determined in Subparagraphs(b)(iii), (iv), and (v) of this Subsection

Commented [HH20]: See Staff Report of April 4, 2018 which discusses the problem with this term which is defined to include negative adjustments that may be passed through in the adjustment year at the federal level.

Commented [HH21]: Need to clarify—assuming this is what is intended.

Commented [HH22]: Here – if the partnership can show that an indirect partner filed and paid tax, that would presumably result in an reduction.

Commented [HH23]: Needed to conform to the new federal pull-in process.

Commented [HH24]: I think this is necessary and what is intended.

Commented [HH25]: This would include Direct and Indirect Partners – which does not appear to be the intent of the Interested Parties.

Commented [HH26]: This would already include Direct and Indirect Partners – which does not appear to be the intent of the Interested Parties, but see the changes made to require that the partnership use best available information.

Commented [ND27]: Edits made to reflect resident v non-resident partner calculations.

C(3).

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

(i) The share of Final Audit Adjustments, including positive Reallocation Adjustments, that must be included in the unitary business income of Corporate Partner required to file a return separately or as a member of a group as provided in [reference to State law];

(ii) Any Final Federal Adjustments resulting from a Administrative Adjustment Request;

(iii) Negative Final Federal Adjustments (other than Reallocation Adjustments, where only the positive adjustments are included) if these adjustments were treated as amounts passed through to adjustment year partners in the adjustment year partnership return under IRC section 6226.

(4) **Tiered Partners.** Each Tiered Partner and each Indirect Partner of an Audited Partnership that reported Final Federal Adjustments pursuant to Subparagraph (a)(ii) of Subsection C(2) shall be subject to the applicable election, reporting and payment requirements for Audited Partnerships and their Direct Partners under this Section C, notwithstanding the interim time requirements in Subsections (2) and (3), and all reports and payments required to be made by such Partners under this Section C shall be completed within 90 days after the time for filing and furnishing statements to Tiered Partners and their Partners as established by the IRS under IRC section 6226 and the regulations thereunder. The [State Agency] may promulgate regulations to establish procedures and interim time periods for the reports and payments required by Tiered Partners and Indirect Partners.

(5) **Modified Reporting and Payment Method.** Subject to the approval of the [State Agency], an Audited Partnership or Tiered Partner may enter into an agreement with the [State Agency] to utilize an alternative reporting and payment method, including applicable time requirements or any other provision of this Section C, if the Audited Partnership or Tiered Partner demonstrates that the requested method will reasonably provide for the reporting and payment of taxes, penalties, and interest due under the provisions of this Section C.

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

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

(b) If properly reported and paid by the Audited Partnership or Tiered Partner, the amount determined in Paragraph (b) of Subsection C(3), or similarly under an optional election under Subsection C(5), will be treated as paid in lieu of taxes owed by its Direct and Indirect Partners, to the extent applicable, on the same Final Federal Adjustments. The Direct Partners or Indirect Partners may not take any deduction or credit for this amount or claim a refund of the amount in this State. Nothing in this Subsection(C)(6) shall preclude Resident Partners from claiming a credit against taxes paid to this State pursuant to [reference to State law], any amounts paid by the Audited Partnership or Tiered Partners on the Resident Partner's behalf to another state or local tax jurisdiction in accordance with the provisions of [State law or regulation allowing credit for taxes paid to another state or locality].

Commented [JH28]: We need to discuss further. We do not think this is necessary with above revisions.

Commented [JH29]: Changed so that statute works even if IRS renumbers regulation.

Commented [JH30]: This optional process is complicated and confusing and seems better suited to be in a regulation. We moved to regulation below and adding additional sentence in sub (4) above.

Commented [FN31]: Changes based on CA proposed language.

Commented [JH32]: Generally covered under state law or by a partnership agreement—not necessary.

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

Commented [FN33]: This appears unconstitutional.

SECTION D. De Minimis Exception

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

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

The [State Agency] will assess additional tax, interest, and penalties arising from Final 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 by the following dates:

- (1) **Timely Reported Federal Adjustments.** If a Taxpayer files with the [State Agency] a Federal Adjustments Report or an amended [State] tax return as required within the period specified in Sections B or C, the [State Agency] may assess any amounts, including in-lieu-of amounts, taxes, interest, and penalties arising from those Federal Adjustments if [State Agency] issues a notice of the assessment to the Taxpayer no later than:
 - (a) The expiration of the limitations period specified in [citation to State statute setting forth normal limitations period]; or
 - (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 Sections B or C, as appropriate, or the Federal Adjustments Report filed by the Taxpayer omits Federal Adjustments or understates the correct amount of tax owed, the [State Agency] may assess amounts or additional amounts including in-lieu-of amounts, taxes, interest, and penalties arising from the Final Federal Adjustments, if it mails a notice of the assessment to the Taxpayer 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]; or
 - (b) The expiration of the one (1) year period following the date the Federal Adjustments Report was filed with [State Agency]; or
 - (c) Absent fraud, the expiration of the six (6) year period following the Final Determination Date.

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

A Taxpayer may make estimated payments to the [State Agency], following the process prescribed by the [State Agency], of the [State] tax expected to result from a pending IRS audit, prior to the due date of the Federal Adjustments Report, without having to file the report with the [State Agency]. The estimated tax

payments shall be credited against any tax liability ultimately found to be due to [State] (“Final [State] Tax Liability”) and will limit the accrual of further statutory interest on that amount. If the estimated tax payments exceed the final tax liability and statutory interest ultimately determined to be due, the Taxpayer is entitled to a refund or credit for the excess, provided the Taxpayer files a Federal Adjustments Report or claim for refund or credit of tax pursuant to [citation to State statute setting forth claim for refund requirements] no later than one year following the Final Determination Date.

SECTION G. Claims for Refund or Credits of Tax Arising from Final 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 tax arising from 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 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 means for the Taxpayer to report additional tax due, report a claim for refund or credit of tax, and make other adjustments (including to its net operating losses) resulting from adjustments to the Taxpayer’s federal taxable income.

SECTION H. 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] is limited to changes to the Taxpayer’s tax liability arising from Federal Adjustments.
- (2) The time periods provided for in [this subdivision of the State Code] may be extended:
 - (a) Automatically, upon written notice to [State agency], by 60 days for an Audited Partnership or Tiered Partner which has [10,000] or more Direct Partners; or
 - (b) By written agreement between the Taxpayer and the [State Agency] [pursuant to any regulation issued under this Section].
- (3) Any extension granted under this Section G for filing the Federal Adjustments Report extends the last day prescribed by law for assessing any additional tax arising from the adjustments to federal taxable income and the period for filing a claim for refund or credit of taxes pursuant to [citation to State statute setting forth claim for refund requirements].

SECTION I. Effective Date

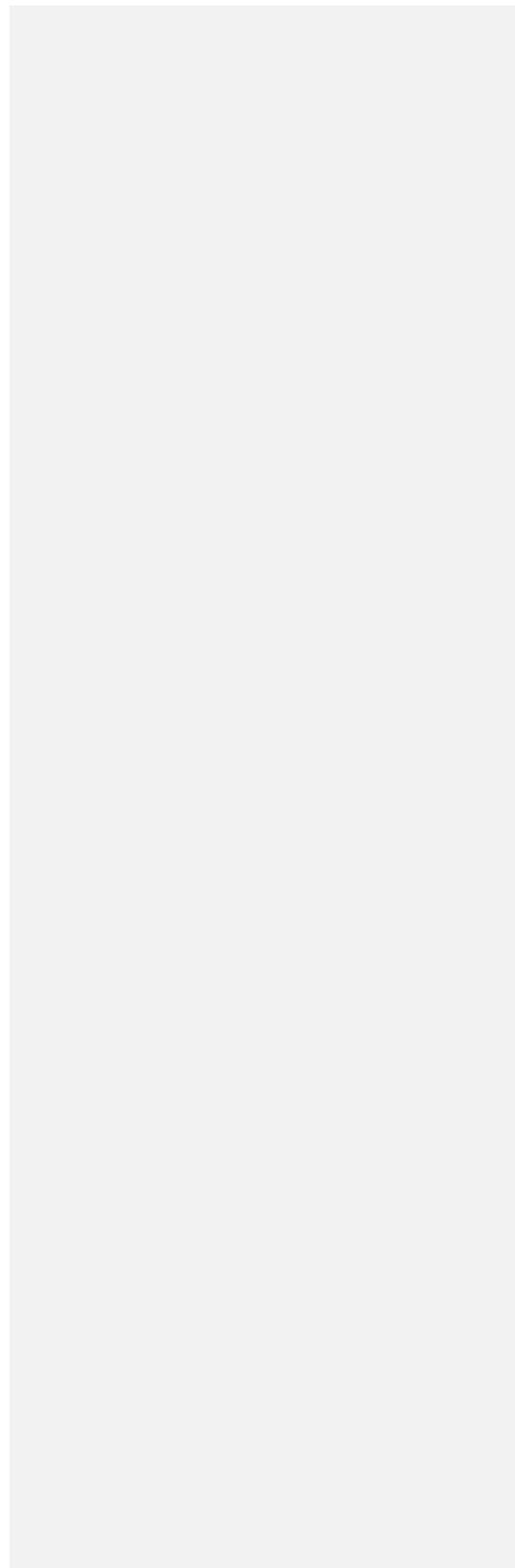
The amendments to this [section/chapter] applies to any adjustments to a Taxpayer’s federal taxable income with a Final Determination Date occurring on and after [date].

* * * * *

**Prepared by a working group consisting of representatives of the Council On State Taxation (COST), Tax Executives Institute (TEI), the ABA Section of Taxation’s SALT Committee, the American Institute of CPAs*

(AICPA), the Institute for Professionals in Taxation (IPT) and the Master Limited Partnership Association (MLPA). As of this date, this draft has not been officially endorsed by these organizations.

* * * * *



Optional Model Regulation or Inclusion in Model Statute

- (1)
 - (a) The “Final Determination Date” that arises from an IRS audit is the first day on which all adjustments to the Taxpayer’s federal taxable income are final, and all appeal rights under the IRC are exhausted, for the Taxpayer’s federal taxable year.
 - (b) 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 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.
- (2) The “Final Determination Date” that arises from the filing of an amended final return, a federal refund claim, or the filing by a Partnership of an Administrative Adjustment Request, is the day on which the amended return, refund claim or Administrative Adjustment Request was filed to the IRS.
- (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 IRC section 7601, including any requisite review by the Joint Committee on Taxation pursuant to IRC section 6405; and (ii) has not filed a petition for redetermination with the United States Tax Court pursuant to IRC sections 6213 or 6234 or a claim for refund with a district court or the United States Court of Federal Claims pursuant to IRC sections 6234 or 7422, and the time for the Taxpayer to timely file the petition for redetermination or 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 IRC section 7121(b).

***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 IRC section 6501.

***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 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.

- (e) 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 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.

- (f) The Taxpayer files an amended return with the IRS.

Example 6: A Taxpayer files an amended return (could be additional tax due or a refund) with the IRS for taxable year 2015 on June 15, 2018. The Final Determination Date for the Taxpayer is June 15, 2018.

- (a) 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 Final Federal Adjustments are de minimis. The Taxpayer shall file that notice with the [State Agency] no later than 180 days following the Final Determination Date. The Taxpayer's notice shall contain information reasonably necessary to provide the [State Agency] with an understanding of the Final Federal Adjustments and their impact on the Taxpayer's [State] tax liability.
- (b) In the event the Taxpayer provides the [State Agency] with notice that the Final Federal Adjustments are de minimis, the [State Agency] may nevertheless request, in writing, that the Taxpayer file a Federal Adjustments Report. The [State Agency] shall mail that request to the Taxpayer no later than 180 days after the date on which the Taxpayer filed the notice with the [State Agency].

- (c) In the event the [State Agency] requests a Federal Adjustments Report, the Taxpayer has 90 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 tax owed by the Taxpayer.
- (d) *[Option 1]* If the Taxpayer notifies the [State Agency] that it owes the State a de minimis tax liability or is entitled to a de minimis [State] tax refund, and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report, the Taxpayer's notice that the adjustments are de minimis will be accepted by the [State Agency], and no tax shall be assessed or refunded.
- [Option 2]* If the Taxpayer notifies the [State Agency] that it would owe the State a de minimis tax liability and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report, the Taxpayer's notice that the adjustments are de minimis will be accepted by the [State Agency] and the [State Agency] may assess and bill the Taxpayer the fixed sum of \$250, which will include statutory interest and penalties.

Absent fraud, the Taxpayer will not be subject to additional assessment, nor 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. (a) Each Tiered Partner of an Audited Partnership that was required to provide a notice pursuant to C(2)(a)(ii) must, no later than 90 days after the date the notice was required to be provided, comply with the requirements for reporting its share of Final Federal Adjustments subject to subsection C(2) or, if it makes a proper election, subsection C(3), as if it were the Audited Partnership. If the Tiered Partner is not a Partnership, then the [State Agency], by regulation or instruction, may provide for the reporting of information to the Partners consistent with otherwise applicable state law.

Commented [ND34]: No edits made to section references.

(b) Each Direct Partner in a Tiered Partner making a report under Paragraph (a) of Subsection C(4) must within 180 days comply with the filing, reporting, and payment requirements of Paragraph (b) of Subsection C(2)(b).

(c) Notwithstanding the interim time requirements in Paragraphs (a) and (b) of this Subsection C(4), all reports and payments required to be made by Tiered Partners and their taxpayer Partners under this section are required to be made within 90 days after the time for filing and furnishing statements to Tiered Partners and their Partners as established by the IRS under IRC section 6226 and the regulations thereunder.

Commented [JH35]: To match change above in main (4)